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How the internet killed the phone business

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A very Japanese revolution

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Politics this week

Sep 15th 2005
From The Economist print edition

AP

Japan's election

Japan's Liberal Democratic Party was returned to power with a sharply increased majority. Junichiro Koizumi, the prime minister, had called a snap election and purged his party after his plans to privatise Japan Post were blocked by rebels. The leader of the opposition Democratic Party of Japan resigned.

See article

A fresh round of six-country talks on **North Korea's** nuclear weapons opened in Beijing. America's lead negotiator complained of little progress.

In **Afghanistan**, the Taliban were blamed for the killing of seven people delivering voter registration papers in the central province of Uruzgan, just days ahead of parliamentary and provincial elections on September 18th.

See article

Manmohan Singh and Pervez Musharraf, respectively the prime minister of **India** and the president of **Pakistan**, met in New York. Hopes of a breakthrough were dashed but Mr Singh did promise to visit Pakistan.

Bailing out

More than two weeks after Hurricane Katrina, the clear-up in **New Orleans** began in earnest. As authorities scaled back their estimate of the region's death toll, George Bush paid two visits to the deluged city (he had previously visited the Gulf coast region) to view the operations. Michael Brown resigned as head of the much criticised Federal Emergency Management Agency.

See article

The Senate held its confirmation hearings for **John Roberts** to be chief justice of the Supreme Court. Following the script, Democrats quizzed him on his attitude towards abortion and civil rights.

See article

The **Massachusetts** legislature voted against a proposed state constitutional amendment that would ban gay marriage, which is legal in the state because of a court ruling. The measure now looks unlikely to be put to the electorate next year.

Fernando Ferrer won the Democratic primary in **New York's** mayoral election, after the second-placed candidate withdrew to avoid a divisive run-off. Mr Ferrer could become the city's first Latino mayor if he beats Michael Bloomberg in November.

World leaders meeting in New York were due to endorse a 35-page declaration on overhauling the **United Nations** and progress towards tackling world poverty. Although greatly watered down in comparison with earlier drafts, the final document was described by both Kofi Annan, the UN secretary-general, and Mr Bush as an important “first step” along the road to reform. Others were more dubious.

See article

Paying the bill

In **Brazil**, opposition parties began proceedings to expel Severino Cavalcanti, the leader of the lower house of Congress. He is accused of extorting payments from a concessionaire who ran restaurants in the Congress building. An unrelated campaign-finance scandal involving the Workers' Party continues to erode the popularity of the government.

Suez, a French utility, said it would withdraw from **Argentina**, where it held 46% of a large water company, after failing to reach agreement with the government over an increase in tariffs, which have been frozen since 2002.

In **Canada**, Ontario's government said that it would not allow Muslims to use sharia law to settle family disputes; instead, it will move to outlaw religious tribunals used by Christians and Jews.

Chile's Supreme Court ruled that General Augusto Pinochet can face a third set of human-rights charges, though he is likely to escape trial on health grounds. The *Guardian*, a British newspaper, claimed that BAE Systems paid the former dictator more than £1m ($1.6m) from 1997 to 2004.

See article

Up for grabs

The opinion polls continued to narrow days ahead of **Germany's election**. Most now suggest that the opposition will not win an overall majority, making the likeliest outcome a “grand coalition” between the main centre-right and centre-left parties.

See article

Norway voted the centre-left into office in a general election. Jens Stoltenberg, leader of the Labour Party, will now form a government, ousting the centre-right government of Kjell Magne Bondevik.

See article

The **European Court of Justice** ruled that the European Commission could, in some circumstances, impose criminal penalties on those who flout European Union laws. The ruling was opposed by many national governments, which argued that the criminal law should never fall within EU powers.

Northern Ireland witnessed its worse riots for years after a parade by the Orange Order was re-routed to avoid a Catholic neighbourhood. Around 80 police officers were hurt in the ensuing violence. The province's top policeman said the Order and loyalist paramilitaries had instigated the trouble; they blame the police.

See article

European finance ministers vowed to stand together against **fuel-price protesters** who are demanding cuts in petrol taxes. But several countries promptly offered subsidies and tax rebates to favoured pressure groups.

See article

The carnage continues

Getty Images

In one of the deadliest days in **Iraq** since the American-led invasion in 2003, at least 150 people were killed and hundreds more injured in a series of bomb attacks and shootings on September 14th. In the worst incident, a suicide bomber blew up his car in the midst of hundreds of labourers, killing at least 114. Al-Qaeda in Iraq claimed responsibility for the mayhem.

See article

Hosni Mubarak won what was billed as **Egypt's** first competitive presidential election with 88.6% of the vote. His main rival in the race, Ayman Nour, won just 7.6% and cried foul. Even more strikingly, only 23% of the electorate bothered to vote.

There were anarchic scenes in the **Gaza strip** as the last Israeli soldiers left. Former Israeli settlements were looted and a synagogue was burned to the ground. Palestinian leader Mahmoud Abbas condemned the “armed chaos”.

See article

In oil-rich **Nigeria,** thousands of people took to the streets in the city of Lagos to protest against a rise of 30% in fuel costs due to cuts in government subsidies.

Somali gunmen who hijacked a UN ship off the coast of Somalia carrying relief food to tsunami victims released the ship and crew after holding them for 11 weeks.

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Business this week

Sep 15th 2005
From The Economist print edition

Flying on empty

Delta Air Lines and **Northwest Airlines** filed for bankruptcy protection. Both companies, like other large American airlines, are contending with cut-throat competition from low-cost carriers, the burgeoning costs of workers' benefit schemes and a sharp rise in the cost of jet fuel. Delta has lost $10 billion since 2001 and Northwest's mechanics are currently on strike.

See article

Ford agreed to sell **Hertz**, its car-rental subsidiary, to a consortium of three private-equity firms for $5.6 billion (including debt, the transaction is worth $15 billion). Last June, the carmaker filed papers to float Hertz on the stockmarket, but a number of buy-out specialists expressed a strong interest in buying it directly instead. The sale provides some much needed liquidity for Ford—its credit rating was downgraded to “junk” status earlier this year.

See article

EBay confirmed that it was buying **Skype**, a leading provider of free phone-calls over the internet. The deal is initially worth $2.6 billion, but could rise to $4.1 billion by 2009 if performance targets are met. Luxembourg-based Skype has excited analysts, who think it will transform the telecoms industry.

See article

Oracle announced another large acquisition. It is buying **Siebel Systems**, a rival business software company, in a deal valued at $5.8 billion. Siebel is Oracle's biggest takeover since its recent contentious merger with PeopleSoft.

See article

A judge ruled that a former executive at **Microsoft**, Kai-Fu Lee, could do some, but not all, of the development work in China asked by his new employer **Google**. Microsoft says Mr Lee knows too much about its strategy in China, but urged Google to accept the decision. The case has highlighted the boundaries that firms can place on former employees.

Not exactly a lazy summer

Lehman Brothers said net income for the three months ending August 31st had risen by 74%, compared with a year earlier, to $879m. Other big Wall Street investment banks are expected to follow Lehman's lead and post equally startling quarterly results.

Wachovia agreed to pay $3.9 billion for **Westcorp**, a financial-services holding company (the

deal includes the 16% stake in WFS Financial, a car-loan company, that Westcorp does not already own). America's fourth-largest bank will double its car-financing business, and also gain a toehold in southern California's retail-banking market—another Westcorp subsidiary is Western Financial Bank.

Deutsche Börse asked Reto Francioni, chairman of SWX Group, which runs the Swiss stock exchange, to be its new chief executive. The German financial-exchange group has been seeking a new boss since May, when Werner Seifert was ousted by shareholders dissatisfied with a bid for the London Stock Exchange.

Banca Popolare Italiana said that it had approved the sale of its 29.5% stake in **Banca Antonveneta** to ABN Amro, of the Netherlands. The sale would seal the first significant foreign takeover of an Italian bank, and end a controversial battle that has lasted several months.

See article

I think Icahn

Carl Icahn put more pressure on **Time Warner**. The investor, who last month revealed that he and three partners had built a 2.6% stake in the company, said he would mount a proxy fight to win seats on Time Warner's board. Mr Icahn's group wants the media giant to spin off its cable TV unit and buy back $20 billion-worth of shares in order to boost its share price.

Vivendi Universal reported a 49% rise in net income, to €1.26 billion ($1.62 billion), for the first half of the year compared with a year earlier. In 2002, the media group posted France's biggest-ever annual corporate loss—€23.3 billion.

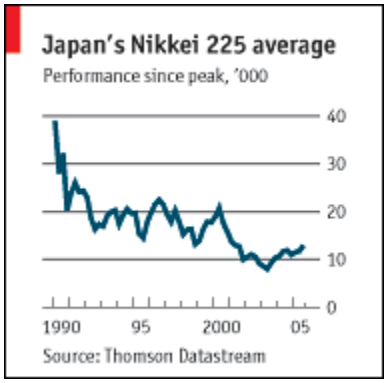
Australia's government overcame strong opposition to pass legislation enabling the sale of its remaining 51.8% stake in **Telstra**, the country's largest telecom firm. Worth A$28 billion ($22 billion) and expected next year, it is the country's biggest privatisation.

EnCana, a Canadian oil-and-gas producer, said it was selling its assets in Ecuador to Andes Petroleum, a consortium of Chinese energy firms that includes **China National Petroleum Corporation**, for $1.42 billion. The deal is further disappointment for India's Oil and Natural Gas Corporation, which was also in the running for EnCana. Last month, CNPC pipped it to buy PetroKazakhstan.

Put it in perspective

Following Junichiro Koizumi's election win, **Japan's** Nikkei 225 stockmarket index reached a four-year high (though this is still a long way from its peak in late 1989). Markets were also buoyed by an upward revision to Japan's second-quarter GDP growth, which stands at an annualised rate of 3.3%.

See article



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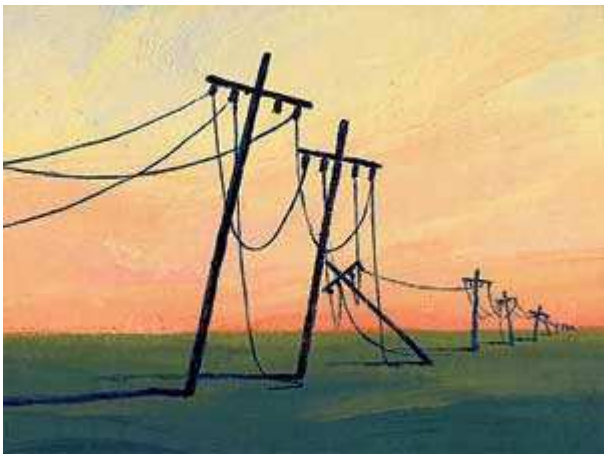
Telecoms and the internet

How the internet killed the phone business

Sep 15th 2005
From The Economist print edition

Almost-free internet phone calls herald the slow death of traditional telephony



THE term “disruptive technology” is popular, but is widely misused. It refers not simply to a clever new technology, but to one that undermines an existing technology—and which therefore makes life very difficult for the many businesses which depend on the existing way of doing things. Twenty years ago, the personal computer was a classic example. It swept aside an older mainframe-based style of computing, and eventually brought IBM, one of the world's mightiest firms at the time, to its knees. This week has been a coming-out party of sorts for another disruptive technology, “voice over internet protocol” (VOIP), which promises to be even more disruptive, and of even greater benefit to consumers, than personal computers (see article).

VOIP's leading proponent is Skype, a small firm whose software allows people to make free calls to other Skype users over the internet, and very cheap calls to traditional telephones—all of which spells trouble for incumbent telecoms operators. On September 12th, eBay, the leading online auction-house, announced that it was buying Skype for $2.6 billion, plus an additional $1.5 billion if Skype hits certain performance targets in coming years.

This seems a vast sum to pay for a company that has only $60m in revenues and has yet to turn a profit. Yet eBay was not the only company interested in buying Skype. Microsoft, Yahoo!, News Corporation and Google were all said to have also considered the idea. Perhaps eBay, rather like some over-excited bidder in one of its own auctions, has paid too much. The company says it plans to use Skype's technology to make it easier for buyers and sellers to communicate, and to offer new “click to call” advertisements, but many analysts are sceptical that eBay is the best owner of Skype. Whatever the merits of the deal, however, the fuss over Skype in recent weeks has highlighted the significance of VOIP, and the enormous threat it poses to incumbent telecoms operators.

For the rise of Skype and other VOIP services means nothing less than the death of the traditional

telephone business, established over a century ago. Skype is merely the most visible manifestation of a dramatic shift in the telecoms industry, as voice calling becomes just another data service delivered via high-speed internet connections. Skype, which has over 54m users, has received the most attention, but other firms routing calls partially or entirely over the internet have also signed up millions of customers.

A price of zero

The ability to make free or almost-free calls over a fast internet connection fatally undermines the existing pricing model for telephony. “We believe that you should not have to pay for making phone calls in future, just as you don't pay to send e-mail,” says Skype's co-founder, Niklas Zennstrom. That means not just the end of distance and time-based pricing—it also means the slow death of the trillion-dollar voice telephony market, as the marginal price of making phone calls heads inexorably downwards.

VOIP makes possible more than just lower prices, however. It also means that, provided you have a broadband connection, you can choose from a number of providers of VOIP telephony and related add-on services, such as voicemail, conference calling or video. Many providers allow a VOIP account to be associated with a traditional telephone number—or with multiple numbers. So you can associate a San Francisco number, a New York number and a London number with your computer or VOIP phone—and then be reached via a local call by anyone in any of those cities.

Furthermore, your phone (or computer) will ring wherever you are in the world, as soon as it is plugged into the internet. So you can take your Madrid number with you to Mumbai, or your San Francisco number to Shanghai. Skype and other VOIP services, in other words, are leading to lower prices, more choice and greater flexibility. It is great news for consumers—but terrible for telecoms operators. What can they do?

Watching the elephants dance

As is always the case with a disruptive technology, the incumbents it threatens are dividing into those who are trying to block the new technology in the hope that it will simply go away, and those who are moving to embrace it even though it undermines their existing businesses. Since VOIP will cause revenue from voice calls to wither away, the most vulnerable operators are those that are most dependent on such revenue.

In particular, that means mobile operators, which have been struggling for years to get their subscribers to spend more on data services, but are still hugely dependent on voice. Worse, the very “third generation” (3G) networks that are supposed to provide future growth for these firms could now undermine them, because such networks make mobile VOIP possible too. Least vulnerable, by contrast, are those fixed-line operators that are now building new networks based on internet technology, which will enable such firms to benefit from the greater efficiency and lower cost of VOIP compared with traditional telephony.

These operators are taking an “if you can't beat 'em, join 'em” approach and getting into the VOIP business. While their voice revenues will slowly evaporate, they will then be well placed to offer fee-based add-on services over their new networks. Again, this is a common pattern with disruptive technologies: forward-looking incumbents can end up giving upstart innovators a run for their money.

It is now no longer a question of whether VOIP will wipe out traditional telephony, but a question

of how quickly it will do so. People in the industry are already talking about the day, perhaps only five years away, when telephony will be a free service offered as part of a bundle of services as an incentive to buy other things such as broadband access or pay-TV services. VOIP, in short, is completely reshaping the telecoms landscape. And that is why so many people have been making such a fuss over Skype—a small company, yes, but one that symbolises a massive shift for a trillion-dollar industry.

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Japan's election

A very Japanese revolution

Sep 15th 2005
From The Economist print edition

How to bring about change by re-electing the same old party

Getty Images

NO ONE ever accused Japan of making itself easy to understand. It has just had its most thrilling general election in decades, possibly ever, a poll called courageously by the prime minister, Junichiro Koizumi, after a post-office privatisation bill had been rejected in the Diet (parliament) in August. At first, that decision looked suicidal. But the maverick Mr Koizumi's gamble paid off: he won a huge mandate, seemingly for radical change (see article). So here comes a new Japan? Look harder, and the fog starts to form.

In Sunday's poll, after all, voters restored parliamentary dominance to Mr Koizumi's Liberal Democratic Party, the same conservative group that has ruled Japan ever since 1955, bar ten months in 1993-94, and which led the country into the financial crash and economic stagnation from which it has suffered for the past 15 years. The election did enable him to expel from the party 37 rebels who had opposed his reforms, roughly 15% of the LDP's pre-election strength, so it has made the party better able to bring about change. Yet in giving the revamped LDP its biggest majority in the main (lower) house of the Diet since 1986, the voters also rejected the chief opposition group, the Democratic Party of Japan, whose manifesto actually promised a more liberal and far-reaching set of reforms than did Mr Koizumi. And the LDP's party rules anyway stipulate that Mr Koizumi has to stand down as its leader, and hence prime minister, in just one year's time.

So this apparently new Japan will be led by the same old party, and the great, purported change-maker will soon be gone. It sounds absurd: rather as if, when Britain's Margaret Thatcher won a landslide election victory in 1983, her fourth year in office just as 2005 is for Mr Koizumi, she then had to stand down in 1984, six years earlier than she eventually did. For that reason, the obvious conclusion is that the LDP will now have to change its rules, to allow Mr Koizumi to serve for at least another year or two. There is already talk of it. Yet the man himself insists that he plans to

retire, on schedule.

The real meaning of the Lionheart

Which is it, then? An exciting victory for radicalism or a very conservative choice? When Japan looks at its most inscrutable, with ritual inside evasion wrapped in confusion, the right answer is often the simplest: it is both, but go easy on the excitement. Mr Koizumi, a self-described “Lionheart”, is a radical but only within quite a conservative context. For Japanese voters probably do not want truly radical change: otherwise they would long ago have gambled on the DPJ, flaky and divided though it is. What most voters seem to want is a steady process of change, and that is what they are going to get, whether or not Mr Koizumi remains for longer as prime minister.

The big policy issue in Japan concerns the size and role of the state. Spending is not high by global standards: 37% of GDP in 2004, which is more than in America but lower than in Britain and far lower than in continental Europe. The problem lies in the composition of the spending, the size of the budget deficit (6.4% of GDP) and the way the state interferes in the economy in other ways. Beginning in the 1970s, high spending on public works turned politics into a pork-barrel affair. In the 1990s, when the economy stumbled, the chosen solution was a great burst of Keynesian public spending, which prevented a slump but also gave a big boost to a corrupt and cartelised construction industry, poured concrete over much of the country's natural beauty and kept the political pork-barrel brimming over. In 1998, as fears grew about the national debt, that spending began to be slashed. The question was how far to go. Mr Koizumi's rise to power, in 2001, reflected the views of those who thought it should go further: that the era of pork-barrel politics was over; that the state institutions that facilitated it must be reformed or privatised; and that the public sector had to be trimmed and revamped in preparation for the inevitable increases in health-care and pensions costs resulting from the shrinking and ageing of Japan's population.

Ex post

That is why a rather arcane subject, the privatisation of Japan Post, caused a big row in the Diet and took centre stage in the election. Japan Post includes a savings bank that accounts for 30% of all personal deposits and a life insurer that has 40% of that market; and its ¥330 trillion ($3 trillion) of assets have long provided the main funding for all those public-works schemes. Now that Mr Koizumi has won, he will have, with the LDP's small coalition partner, the Buddhist-backed New Komeito, a two-thirds majority in the lower house, which is enough for him to override the upper house, which rejected the postal bills in August. Yet he is no Thatcherite. In trimming back the public sector, he represents a sort of accelerated continuity of policy since 1998, not a sharp change. And look at his postal bills: although the savings bank will be made to operate in a more commercial manner from 2007 or 2008, it will not be sold off until 2017.

Beyond the postal privatisation, the government needs to do four main things in domestic policy. It needs to avoid messing up the economic recovery that is already under way, which argues against rapid cuts in public spending and against tax rises. It needs to dismantle the other institutions through which the state has guided and distorted the economy: Mr Koizumi has already reined in a mortgage lender, the Housing Loan Corporation, and next he plans to do the same for the other eight state lenders. The government needs to sharpen competition in the private sector, partly by deregulating but more by strengthening antitrust enforcement: ideally, by elevating the Fair Trade Commission, the trustbuster, to cabinet status and giving it many more lawyers and inspectors. Finally, it needs to find ways to reform the two big future burdens on the public purse: health care and pensions.

Those tasks do not require Thatcher-style shock therapy: the time for that was the mid-1990s,

and neither voters nor politicians wanted it. They need a long, steady process, with public-sector reform at the centre of the debate. That is what Mr Koizumi has achieved. Just don't get excited about it.

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Economist.com OPINION

Poverty in Latin America

Not always with us

Sep 15th 2005
From The Economist print edition

Social programmes that are good for democracy as well as for the fight against poverty

Reuters

WHILE world leaders, meeting this week at the United Nations, once again pledged to help Africa, the many poor people in another part of the developing world, Latin America, attract little notice. There is a reason for that oversight: all but a wretched pair (Haiti and Nicaragua) of Latin American countries are officially classed as “middle-income” and all (except Cuba) are democracies.

Latin America is less of a stain on the world's conscience. Yet it has another trait: a hugely unequal distribution of income and wealth. A disproportionately large number of Latin Americans are poor—some 222m or 43% of the total population, of whom 96m (or 18.6% of the total) live in extreme poverty, according to the UN. Behind those figures lie not just human suffering but also an unfairness that is inimical to democracy—making many question its value.

Fortunately, there are some reasons to think those figures will soon improve—and not just because many Latin American economies are growing strongly again after several years of stagnation or worse. The region's democratic governments have started to make big and innovative efforts to tackle poverty. These centre on programmes that offer poor families cash payments on condition, for example, that they keep their children in school and take them for regular health check-ups. In Mexico, 5m families now get such payments, and 7.5m in Brazil (see article). Other countries, such as Colombia and Nicaragua, have set up similar schemes. They are also attracting interest and imitators beyond Latin America.

With good reason: if well done, these conditional cash-transfer schemes, as they are called, have several advantages over traditional social spending. Unlike public pensions or social insurance (which mainly benefit the better-off) or indiscriminate subsidies, they target the poor. The aim is both to help them and to break the cycle of poverty by giving their children a better chance to

escape it. The money is normally paid to women (who spend it better than men). Payments—the equivalent of $50-70 a month—are high enough to make a difference but low enough not to distort labour markets by removing the incentive to work. The fiscal cost is fairly modest.

The idea seems to work. In Mexico, the poverty rate fell between 2000 and 2002 during a recession in which real income per head declined by some 3%. Studies suggest that children in the beneficiary families are less likely to be stunted by poor nourishment and less likely to drop out of school.

The new programmes are not a panacea. They require an effective state. In some cases, targeting and monitoring need to be improved. And their impact should not be exaggerated. Experience shows that the best way to lift millions out of poverty is rapid economic growth.

But there is another merit in the new programmes. In Latin America, social benefits have traditionally been given in return for political loyalty. The cash transfers are—in theory and generally in practice—made according to need. In Mexico and Brazil, they have continued under governments of different political complexion. Above all, they show that democracies are responding to the needs of their poorest citizens. And that gives more Latin Americans a stake in democracy too.

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Economist.com OPINION

Hurricane Katrina

Whoaaah

Sep 15th 2005
From The Economist print edition

Mr Bush is doing better, but throwing money at the problem may make a bad mess worse

AP

THIS week saw something of a turning point for both New Orleans and George Bush. Down on the Gulf coast, some sense of order returned to the flooded city (see article). Meanwhile, the president began to act presidentially. Mr Bush belatedly took "responsibility" for the failures of the federal government in the aftermath of Hurricane Katrina. He also belatedly pushed out Michael Brown, a horse expert whom he had foolishly appointed to run the Federal Emergency Management Agency.

The arguments about who got what wrong will have a big impact on American politics (see article). But the main priority for Mr Bush should be avoiding any further mistakes—and there are worrying signs. "Nothing can salve the wounds like money," a White House official told *Time* magazine last week. That is the prevailing wisdom in Washington, DC, as politicians rush to atone for their earlier incompetence. Some $60 billion has been pledged for post-hurricane relief and reconstruction (with far, far more to come) and some contracting rules about competitive bidding have been loosened.

When it comes to immediate relief, this is understandable. Some of the cash will no doubt be wasted through cronyism and fraud, but America has been shamed by its inability to look after the destitute. The bigger problem lies ahead with the money that is supposed to go to reconstruction. That is partly because the numbers are far larger. But it is also because throwing money at the Gulf coast now may set America up for an even bigger mess when the next natural disaster strikes.

Consider the question of how to rebuild New Orleans. Dennis Hastert, the Republican speaker of the House of Representatives, recently suggested that some areas of the city could be bulldozed; so great was the outcry at this cruelty that he had to issue an apologetic clarification. This is

nonsense. Many of the worst-hit areas were not just unusually vulnerable to flood; they were also among the most squalid places in the country. They should not be brought back.

Even if Mr Bush thinks he has a responsibility to rebuild a new New Orleans, some transparent weighing of costs and benefits is needed. Too much federal cash for reconstruction will encourage yet more development along the hurricane- and flood-prone Gulf coast. And the “moral hazard” extends well beyond the South: the more cash that is spent rebuilding New Orleans, the more foolhardy Californians will be about where they build in their earthquake-prone state, confident the government will bail them out if the “Big One” strikes.

A big part of the problem is America's system of insurance against natural disasters. Hurricanes are covered by the private market but, since 1968, the federal government has been responsible for the provision of flood insurance. The reasoning was that, since flood victims expected to be bailed out by the government anyway, they might as well pay up front.

The division between flood and hurricane now sets up the spectre of endless lawsuits between insurers and the homeowners over whether the damage was caused by wind or water. Meanwhile, although federal flood insurance was both subsidised and supposedly obligatory for most mortgage holders, remarkably few people on the Gulf had federal cover: less than a fifth along Mississippi's coast and only 40% in New Orleans. People bet that if a hurricane struck, the government would bail them out. In California, for much the same reason, only one in five homes is insured against earthquakes.

The cleanest approach would be to get rid of federal flood insurance entirely and let the private market price the risks of living below sea level or in flood-prone areas. The problem is that the inevitability of government bail-outs will persuade many not to pay up. An alternative would be to make natural-disaster insurance (covering floods, earthquakes, avalanches and so on) obligatory, with premiums more closely reflecting the risk. The system could be run for profit by the private sector, with the government, in effect, acting only as an insurer of last resort. This would cost homeowners money and force them to be more careful about where they live; but that, surely, is the point.

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Germany's election

Time for a change

Sep 15th 2005
From The Economist print edition

On September 18th Germans should vote for the opposition candidate, Angela Merkel

Reuters

Get article background

GENERAL elections around much of Europe tend to be boring. Often the government they lead to is a product as much of backroom deals as of the voting. The German election campaign has duly been dull, and coalition manoeuvring has already begun; but the vote's importance to Germany's future, and Germany's importance to the European Union's future, have lent some spice to the affair.

The centre-left government that took office under Chancellor Gerhard Schröder in 1998, and was re-elected in 2002, has not been a success. Its most urgent task was to reform Europe's biggest economy. Yet growth has been slower in Germany than in any other EU country. Unemployment is close to 5m, way over the 3.5m target that Mr Schröder asked to be judged by in 1998. He has brought in some reforms, but he started most of them too late; and his reforms were watered down by opponents in his Social Democratic Party (SPD) and by the opposition's grip on the upper house, or Bundesrat.

Mr Schröder's foreign policy has been even more of a mixed bag. In Kosovo, he lifted a taboo by sending German troops into combat for the first time since 1945. But by campaigning hard in 2002 against war in Iraq, he poisoned Germany's relationship with America. He has been too forgiving of Vladimir Putin's shift to autocracy in Russia. As for the EU, after a promising start he allied himself too tightly to France's Jacques Chirac, opposing economic and budgetary reform.

Given this record, it is perhaps surprising that the leader of the opposition Christian Democrats (CDU), Angela Merkel, is not further ahead. Instead, her lead has been shrinking (see article). Part of her problem is that Mr Schröder is an inspiring and persuasive campaigner, where she is pedestrian. But she is also suffering because, even though voters are dissatisfied, they are fearful

of radical change. Many have been turned off by Ms Merkel's choice of Paul Kirchhof, who advocates such measures as a flat tax, as her potential finance minister.

In truth, Mr Kirchhof's radicalism puts off many in the CDU as well as in the SPD. So the real problem with a Chancellor Merkel is that she may not be radical enough. Thanks partly to the reforms that Mr Schröder began, the German economy is well-placed to rebound—so long as the reforms are continued and enlarged. But the CDU and, even more, its Christian Social Union sister party are in many ways social democrats by another name. The only avowed liberals are the Free Democrats (FDP), Ms Merkel's preferred coalition partner, and even they tend to be more liberal in theory than in practice.

Even so, a Chancellor Merkel at the head of a coalition with the FDP would have two big advantages. In foreign policy, she would be more Atlanticist, more critical of Russia and less closely tied to France within the EU. And in domestic policy, she would benefit hugely from her party's control of most German states, and thus of the Bundesrat.

That is also the objection to a “grand coalition” between the CDU and the SPD, a prospect that looms closer as the gap between the two main parties narrows. Many Germans like the notion of both parties getting together to tackle the country's problems. Yet in practice a grand coalition, led by a Chancellor Merkel weakened by her failure to win a majority, with an embittered SPD many of whose members believe that reforms cost them the election, would be unlikely to produce much in the way of change. For Germany's sake, and for the sake of reform right across the EU, voters should do their best to give Ms Merkel's Christian Democrats and their allies a clear majority on September 18th.

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Letters

Sep 15th 2005
From The Economist print edition

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Germany's minority group

SIR – Your contention that the only hope for German liberalism is a coalition between Christian Democrats (CDU) and the Greens sounds absurd ("Liberals in the wilderness", August 27th). The CDU, especially its premiers in the *Länder*, has always talked down proposals for vital tax reform and its belief in state interventionism is widespread; no courageous market-based suggestions for reforming the health or pension systems can be found in their election manifesto. Also, the Greens are not the champions of civil rights that you make them out to be. They have given their consent to some of the most drastic reversals of civil rights recently, such as giving the police extensive powers to eavesdrop on phone conversations. Nor did they oppose Gerhard Schröder cosying up to autocrats in China and Russia, ignoring the growing repression in these countries.

By contrast, the Free Democrats have a much clearer and consistent liberal programme. The party learnt from its mistakes in 2002 and has spent the last three years formulating new and radical ideas for liberal reforms in taxation, health and education. In Parliament, the party has helped to pass important new legislation expanding civil liberties, such as a Freedom of Information Act. Both its record and its courageous programme, which does not shy away from uncomfortable truths, deserved a fairer hearing.

Otto Count Lambsdorff
Former minister of economic affairs
Bonn, Germany

SIR – Your article could be rewritten for American libertarians, whose views are similar to those of German liberals. All that's needed are a few name changes. Substitute the Republicans for the Free Democrats and the Democrats for the Social Democrats. A major difference is that the Republican Party's dramatic abandonment of its low-spending, decentralist and voluntarist principles is much more recent than the FDU's. An interesting question is whether there will be a long-run reversion in this process. Will the Republicans return to their historic principles? If not, American libertarians will remain homeless, like the German liberals depicted in your article's illustration.

Ted Frech
Santa Barbara, California

SIR – You are right. Liberal creeds, however understood, have a hard time in Germany—as they do in almost every other country.

Rudolf Richter
Saarbrücken, Germany

HIV infection rates

SIR – Edward Green cites a 2003 UNAIDS study as having concluded there is no evidence that more condoms equals lower HIV infection rates among Africans (Letters, August 13th). UNAIDS has not published such a claim in any of its reports. The joint UNAIDS, UNFPA and WHO statement on condoms clearly states: "The male latex condom is the single, most efficient, available technology to reduce the sexual transmission of HIV and other sexually transmitted infections. Conclusive evidence from extensive research among heterosexual couples in which one partner is infected with HIV shows that correct and consistent condom use significantly reduces the risk of HIV transmission from both men to women, and also from women to men."

Purnima Mane
Director of policy, evidence and partnerships
UNAIDS
Geneva

Ignoring Uzbek's rights

SIR – You rightly deplore the failure of the European Union to pursue any action against Uzbekistan's government for the massacre in Andijan ("Punishment please", August 27th). The EU is currently led by Britain. In the autumn of 2004, Britain's Foreign Office sacked its outspoken ambassador to Uzbekistan, Craig Murray, after he dared publicly criticise the atrocious human-rights record of President Islam Karimov's regime. If Britain were now forcefully to call for an investigation into the massacre, to be followed by the appropriate sanctions, that would imply that Mr Murray may, in fact, have had a point. Would it be overly cynical of me to see a connection here?

Christopher Peters
Moscow

The great leap forward

SIR – Your description of China as a "totalitarian regime" strikes me as imprecise, if not downright inaccurate ("Back on the leash", August 20th). A totalitarian regime subordinates the individual to the state and strictly controls all aspects of life by coercive measures. By contrast, an authoritarian regime concentrates political power in an authority not responsible to the people. Post-Deng China is closer to the latter than the former. Totalitarian is a label generally applied to the most pervasively controlling regimes (Nazi Germany, Stalinist Russia, Maoist China, North Korea). Do you truly believe that China is totalitarian today, given the explosion of freedom in economic life there? Does it really deserve to be grouped in the same category as North Korea?

Daniel Cisek
Washington, DC

Still finger lickin' good?

SIR – Your article on Kentucky Fried Chicken did not mention that sales have dropped since 2003 because of protests against its treatment of poultry ("By the bucket", August 27th). Moreover, KFC lost animal welfare advisers because the company refused to make even the minimal changes suggested by them. Three top advisers to the meat industries in Britain, Canada and the United States recently resigned as advisers to KFC after they were asked to sign an agreement preventing them from speaking publicly about its animal welfare policies.

Every top poultry expert in North America and Europe agrees that “controlled-atmosphere killing” (CAK), which puts chickens to sleep by removing the oxygen from their environment and replacing it with an inert gas, would be a huge improvement on current slaughter methods that are horribly cruel and would be illegal in the United States if they were cows or pigs, instead of birds.

Bruce Friedrich
People for the Ethical Treatment of Animals
Norfolk, Virginia

HAL wouldn't allow it

SIR – Another reason why we consumers are reluctant to adopt electronic computer-controlled centres in our homes is speed (“The home of the future”, September 3rd). Turning on my radio takes barely a second with one press of a button. But to wait for Windows to start up, then activate the internet, navigate to a radio site and start the streaming download takes longer than I care to wait. If Microsoft plans to start connecting its “seamless” computer hubs to my fridge, I'd best start writing my 2008 grocery lists now.

Jonathan Jones
Leamington Spa, Warwickshire

SIR – You mention a Sears catalogue that offered a “food processor doubling as a pleasure vibrator for women”. Do please elaborate on how this worked? Who did what to whom and what fitted where?

Alan Morgan
Mas Canet, France

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Economist.com SPECIAL

Japan's election

Koizumi gets his way

Sep 15th 2005 | TOKYO
From The Economist print edition

The prime minister's landslide victory will solve only some of Japan's problems. But a new Japan is clearly emerging, and there seems to be no turning back

Get article background

IN A country that so often settles for mixed messages, the stunning victory of Junichiro Koizumi this week is a clear signal from Japan's voters. They are ready and eager to break with outworn special interests and modernise the ties between their government and the economy. The public may not know quite how to go about it; but having given their champion a clear mandate, and with economic recovery at last gathering force, the Japanese have more cause to be optimistic than they have had for a very long time.

Since he took over as prime minister in 2001, Mr Koizumi has complained loudly about the conservative “forces of resistance” that riddle his own Liberal Democratic Party (LDP), which has governed Japan almost continuously for the past half-century. For four years, however, he has had to temper those complaints with compromise, as his opponents in the LDP have blocked or diluted his efforts to shrink Japan's overweening state. A month ago, fed up, he decided to risk his career and plans publicly, with an election. On September 11th voters emphatically backed his message, rewarding his coalition with a two-thirds majority in parliament.

During the campaign, Mr Koizumi told the public repeatedly that he wanted the election to be about one issue: his plans to privatise the post office, which not only delivers the mail but is also the world's largest financial institution. Japan Post uses its network of 24,700 branches to collect

state-subsidised bank deposits and life-insurance premiums from tens of millions of Japanese citizens, and thus controls a staggering ¥330 trillion ($3 trillion) in household financial assets. Mr Koizumi wants to liberate that wealth from state hands, both to cut off the flow of funds to special interests and to let the market find better uses for Japan's massive pool of savings.

When rejectionist members of his own party helped to defeat his plan in parliament, Mr Koizumi dissolved the lower house, called an election and refused to support the campaigns of the 37 lower-house LDP members who had opposed it. He then recruited a team of high-profile candidates—dubbed “assassins” by Japan's media—to challenge the LDP rebels in their home districts and campaign for postal privatisation. The result: Mr Koizumi's purged LDP won 296 of parliament's 480 seats, its biggest haul since 1986; the LDP and its coalition partner, the Buddhist-backed New Komeito, now hold a two-thirds majority that can overturn any upper-house vetoes; and 20 of the LDP rebels are no longer in office. As for Mr Koizumi himself, he is so popular that when he was found to have served Mimolette cheese, a pricey French import, to a colleague in his office, Japan's biggest online shop sold out of the stuff.

Mr Koizumi's victory looks even more encouraging in light of the economic news. Japanese companies have been making bumper profits since 2002, helped by strong global demand and heavy Japanese investment in China. As those profits have worked their way through the economy, the country has begun to shake off the burdens that weighed it down after its asset-price bubble burst in 1990. Japan's banks, which played a central role in its long stagnation, are healthier than they have been in over a decade. And the overall economy is stringing together an increasingly reassuring record of growth. On September 12th, revised figures showed that GDP grew at a 3.3% annual rate in the second quarter.

More important, this gathering momentum is starting to feed through to Japan's labour market. Full-time employment has risen sharply this year. As the evidence of a jobs recovery has mounted over the past couple of months, it has fed hopes that higher wages and confident workers will spur consumer spending. Growing domestic demand will allow Japan's economy at last to begin rising of its own accord, without relying so much on a strong tailwind from exports and the global economy.

It will also mean something else. Within a few months—perhaps by the time Japanese families are buying two-storey rice cakes for their New Year gatherings—Japan will be celebrating the return of inflation. In most other countries, that would hardly seem cause for cheer. But in Japan, where average prices—and wages—have been falling for nearly a decade, the deflationary spiral has done extensive damage to the economy. It has distorted markets, depressed revenues and delayed vital changes, while making the real burden of Japan's huge public debts—now 160% of GDP—seem all the more daunting. So it is great news indeed that those deflationary pressures are gradually easing, and should soon give way to rising prices.

The DPJ's usefulness

Between Mr Koizumi's winning campaign and the economy's growing strength, it is little wonder that investors are pleased. In the five weeks since the prime minister decided to dissolve parliament, Japan's stockmarket has risen by 10%. Yet some doubters are grumbling. Voters, they think, may have done more harm than good by handing Mr Koizumi's LDP such a huge victory. They also complain that his reform agenda, beyond postal privatisation, is fairly limited.

These criticisms stem from the LDP's dominance of Japanese politics. It has been in government for all but ten months since 1955, and has often acted less like a political party than like a club that allows the powerful to take turns in office. Many reformists have been counting on the emergence of two-party politics to spice up Japan's democracy. They point out that the main

opposition party, the Democratic Party of Japan (DPJ), has tried to make politicians more accountable by publishing clear manifestos that outline its national plans.

Those plans, moreover, call for reforms that are often more sweeping than anything Mr Koizumi has proposed. The DPJ wants to merge disparate pension schemes, to make them fairer and simpler, and to overhaul the health-care system and its finances, something that the LDP has helped the doctors' association to oppose. The opposition party has also campaigned to transfer more power from central bureaucrats to local governments; to cut public-works spending even more than Mr Koizumi has; and to slash the government's civil-service payroll by 20%.

In short, the DPJ has been a handy opposition party to have around during the past few years, and could perhaps do Japan some good if it were to win power. Yet it lost more than one-third of its 177 seats this week, and must now try to hold itself together. As a result, Mr Koizumi's detractors argue, he has merely given a new lease to the LDP system that has held Japan back for so long.

These worries probably give too little weight to Mr Koizumi's own reformist message, and thus to the political importance of the resounding victory that he has just won. He has, after all, consistently pointed out the flaws in his own party, and has even threatened to destroy the LDP if necessary. He clearly wants to change the party, and has just helped a swathe of new LDP members to win office—many of them with urban constituents, who have different and broader interests from those of the old, rural-based LDP. And his mandate from the voters is resounding.

The prime minister's first act will be to privatise Japan Post. The immediate impact will be small, spread over the course of a decade beginning in 2007. But it will complement the “big bang” financial reforms enacted under Ryutaro Hashimoto in 1997, which deregulated some financial services and introduced more competition into Japan's capital markets.

Mr Koizumi also hopes to follow this with reforms to the nine other public financial institutions that the government operates. These channel state-backed loans to a range of special interests, from small businesses to farmers to infrastructure projects. Mr Koizumi has already forced one of these institutions, the Housing Loan Corporation, to get out of the direct-lending business. Over the past few years, private banks have rushed in to fill the gap by supplying viable borrowers with mortgage loans.

The prime minister will be lucky to accomplish much more than that during the next year. After that, LDP term limits require him to step down, and Mr Koizumi insists that he has no wish to amend those rules and stay in office.

Steadily improving numbers

The economy is now in such good shape, however, that it can probably keep expanding on its own momentum, even if Mr Koizumi and his successors do little else by way of reform. Since the bursting of the bubble in 1990, Japan has had several economic upswings; each time, they have failed to take hold. This time looks different because it has begun to solve the underlying problems that have frustrated a lasting recovery.

These structural flaws are invisible to those who have watched Japan's stagnation from a distance. Infrequent visitors to Tokyo invariably mention how contented and well-dressed the shoppers look as they walk along the capital's clean, safe streets. Much of the pain has been spread out across the countryside, where jobs have been lost, small firms have gone under and suicide rates have risen.

Even without a visit to Tokyo, many outsiders cannot understand how a country with so much impressive technology, which it continues to export in quantity, could be in such trouble. Toyota and Honda, for example, continue to build new factories in North America, and are raking in profits there even as local firms such as Ford and General Motors struggle. But exports are only 10-12% of Japan's economy, and domestic demand has been moribund throughout the country's “lost decade”. While Toyota was taking over the world, car sales in Japan fell by 16% between 1990 and 2001.

Although other countries have seen bubbles collapse, Japan had two particular disadvantages. First, it was saddled with masochistic central bankers who insisted that deflation would be good for Japan, much as bleeding was once considered the best treatment for the sick. Second, the country's business leaders, bankers, regulators and politicians conspired to ignore the true scale of Japan's bad debts in the wake of the bubble's collapse. Instead of using taxpayers' money to recapitalise banks, so that they could write off the loans to their worst borrowers, they looked the other way and hoped that it would somehow, some day, work out for the best.

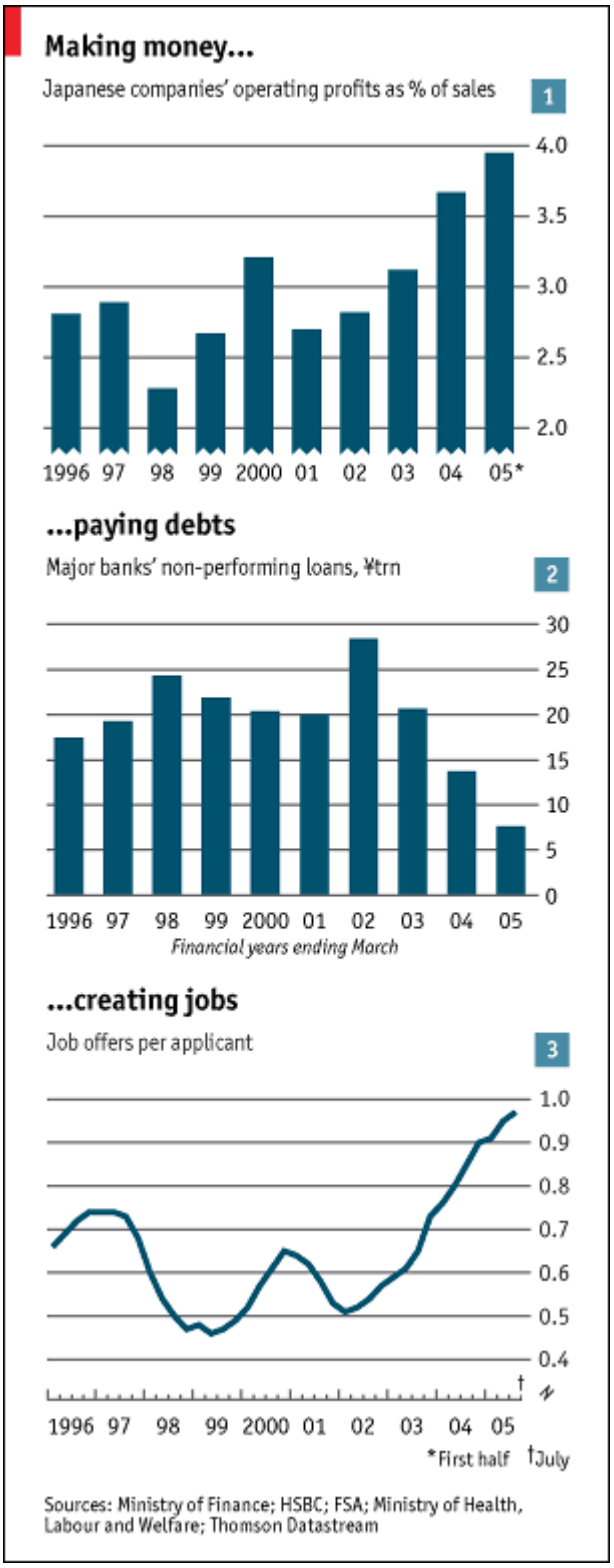
This led to huge misallocation of resources, as banks lent good money after bad in order to keep their deadbeat borrowers on life support a little longer. Anil Kashyap, an economist at the University of Chicago's business school, points out that in many sectors, such as construction and retailing, Japan was consistently channelling its resources towards the least efficient companies during the 1990s.

In a deflationary environment, and with these insolvent companies undercutting them at every turn, even many of Japan's healthy companies could not turn their businesses round. Many of them cut costs heroically. But when everyone is slashing payrolls, then workers' pay, confidence and spending are all under pressure too, which makes it hard for anyone to boost revenues.

Japan's setbacks were often blamed on other factors, such as an ill-advised increase in consumption taxes in 1997 and the global collapse of the information-technology sector in 2000. Those were not the real problem, however. With prices falling and the banking sector dysfunctional, Japan was simply too weak to withstand any downdrafts that it encountered.

A Chinese wind

That dreadful situation has at last begun to resolve itself over the past three years, as a helpful wind from China has finally stayed strong enough, for long enough. Japanese companies have been boosting their spending on new plants and equipment, as makers of cars, electronics and other goods began ramping up their investments in China and other overseas markets. Those companies then began buying more Japanese components and materials for their overseas factories. The resulting demand began to boost revenues; and because Japanese firms had already cut costs sharply, their profit margins began rising sharply too (see chart 1).



Those higher profits, which Japan has now sustained for three years, have changed everything. As they continued to rise, spreading from big manufacturers to small ones, and then to many services companies, a whole swathe of corporate Japan is now able to pay its debts. The longer this profit boom has continued, the better life has become for Japan's lenders. The banks' bad loans have fallen dramatically, from ¥28.4 trillion (8.7% of the total) in March 2002 to ¥7.6 trillion (2.9%) now (see chart 2). And since their balance sheets are stronger, they have been able to cut off

loans to the worst companies, which can no longer suck the life from their healthy competitors.

The firms that have survived this process are thus much fitter, on the whole, than they have been in years, and are confident enough to begin betting on Japan again. Jesper Koll, an economist at Merrill Lynch in Tokyo, points out that besides building factories in China, Japanese firms such as Canon and Toshiba are investing in new plants in Japan again as well.

Companies are also hiring again. The unemployment rate has fallen from 5.4% at its peak to 4.4%. The ratio of job offers per applicant is at its highest level since 1992 (see chart 3). And after a couple of years of expanding using temporary and part-time workers, Japanese firms have begun to take on more full-time staff. Wages are starting to rise, and reliably higher spending does not seem far behind. Toyota, though still keen on exports and overseas factories, is now selling its luxury Lexus cars in its home market for the first time.

In short, Japan is entering a new phase of sustainable economic growth, regardless of what Mr Koizumi does or fails to do. This does not mean that politics is irrelevant, however. Even as Japan begins to look more like a normal advanced economy, it will still have the same problems as other rich countries.

Indeed, Japan's challenges will remain, in many ways, tougher. Not only will it face a demographic crunch sooner—its population will begin shrinking by 2007, and may already have begun to do so—but it is burdened with the leftover costs of its go-slow approach to the bursting bubble.

One of these is a young workforce that is still largely untested. A generation of young Japanese has grown up with part-time jobs, temporary work and a breakdown of vertical authority, in a system that long relied on stable employment and seniority to give workers the training they needed. If this cohort of workers emerges with weaker skills than previous ones, it will be harder to boost productivity and hence long-term growth. Nor can Japan rely on imported labour for a jolt, since it is still squeamish about immigrants.

Still, the news for this generation is hardly all bad. They value creativity more, and have more choices open to them, than their predecessors. Women still have far fewer opportunities than their counterparts in western democracies, but their situation is also improving. Every week, the *Nihon Keizai Shimbun*, Japan's biggest business daily, carries a “working woman” section filled with career and investment advice. Young women no longer have to leave the country to shine.

The other challenging set of hangovers relates to Japan's public debt, and that is why Mr Koizumi's emphatic victory this week is so welcome. If he indeed steps down next September, he will scarcely be able to touch the problem before he passes the torch. Fortunately, however, many of the changes that have accelerated on his watch are starting to look irreversible. His main contribution to Japan has been to build on changes in the political system that were already under way, and to show future politicians how powerful those new tools can be if used well.

Mr Koizumi has done this by building on the gradual reforms of his predecessors. These have laid the groundwork for more powerful cabinets, which should make it easier for future prime ministers to set their own agendas. He has also brought a lot of fresh blood into the LDP, and given its leaders more authority. Perhaps most important, Mr Koizumi has used this election to demonstrate to everyone, including the voters themselves, just how much the electorate has changed, and matured, over the course of Japan's dismal decade.

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Hurricane Katrina

Now the rebuilding begins

Sep 15th 2005 | WASHINGTON, DC
From The Economist print edition

EPA

Progress at last. But as the first of three pieces on Katrina's aftermath explains, George Bush now faces a new set of challenges

AMERICA saw a new side to George Bush this week. A president who hates to acknowledge mistakes admitted that he had messed up. “To the extent that the federal government didn't fully do its job right, I take responsibility”, he said on September 13th. And a president who is famously loyal to his staff effectively fired one of them. Michael Brown, the embattled head of the Federal Emergency Management Agency (FEMA), resigned on September 12th. Mr Bush had earlier praised the man from the Arabian Horse Association for doing “a heck of a job”.

After a fortnight of political flat-footedness, Mr Bush is showing some leadership. He spent the night on a warship and toured New Orleans in a military truck on his third visit to the region. As *The Economist* went to press, the White House was planning a fourth trip together with a televised address to the nation from Louisiana, focusing on the region's future and how the federal government would help.

Whatever details Mr Bush lays out, one thing is clear. They will involve money—and lots of it. Congress has appropriated more than $60 billion to cover the immediate costs of the disaster.

Already there are grumbles about cronyism. FEMA, an agency not used to dealing with huge contracts, is shovelling out hundreds of millions of dollars a day. After the Bush team's spotty record on awarding contracts in Iraq, criticism is hardly surprising (a Halliburton subsidiary got one of the early post-Katrina contracts). The world of disaster relief is an incestuous one: both Joe

Allbaugh, Mr Bush's first FEMA director, and James Lee Witt, Bill Clinton's FEMA director (and now an adviser to Louisiana's governor), have consulting companies that help firms navigate the government bureaucracy.

The really big money—and the bigger political tests for Mr Bush—lie in the knottier medium-term questions. What role should the federal government play in rebuilding the Gulf coast? How much money is needed? What can be done to get America better prepared for the next natural disaster? In each of these areas, there is no shortage of ideas. At issue is whether Mr Bush will pick the right ones.

Take the question of how to rebuild New Orleans. Holed up in Baton Rouge, the city's exiled business leaders are already plotting a quick come-back for the French Quarter and other tourist traps, most of which saw little serious damage. Shopkeepers and restaurateurs are returning to the city (see article).

But other experts of every stripe are offering their ideas to remake a better New Orleans. Engineers have plans to raise not just levees but the entire foundations of the city by several feet; environmental scientists want to restore vast tracts of wetlands to protect against future floods; urban planners want to rejig the city's economic and racial make-up by mixing low-income housing into more affluent neighbourhoods.

In theory, these decisions will not be micro-managed from Washington, DC. Mr Bush has already said that the choices about how to rebuild New Orleans lie with the city's inhabitants. But the size of the federal contribution, and where it is spent, will be easily the biggest factor in shaping the future of New Orleans.

Some politicians have called for a bipartisan commission to lead the rebuilding effort, headed by some nationally respected “reconstruction tsar”, such as Rudy Giuliani or Colin Powell. The White House is considering this. Many economists are calling for a weighing up of the costs and benefits. For instance, Robert Hahn of the conservative American Enterprise Institute thinks a panel of experts from the National Academy of Sciences should study the issue. None of that is likely. In the real world of Washington, two factors will loom largest in how the government approaches reconstruction: political ideology and, more important, the power of lobbyists.

Although infrastructure expenses will be paid directly by the federal government (rebuilding or strengthening levees, for instance, is the job of the Army Corps of Engineers), the White House is already giving hints that it wants the post-Katrina assistance to showcase its preferred kind of government: more focus on tax incentives and vouchers than big federal hand-outs. A package that includes tax credits to encourage employers to hire Katrina evacuees and tax breaks for the evacuees themselves has been introduced in the Senate.

In some cases, however, the Bush team's actions are at odds with this philosophy. FEMA, for instance, is working to amass up to 300,000 trailer homes for evacuees. Its goal is to put 30,000 families in trailers every two weeks, homes in which they could stay for up to five years. One FEMA official has suggested this programme is near the scale “of building the pyramids”. Low-income housing advocates are horrified, viewing the mass trailer parks as an expensive way to create refugee camps and to concentrate poverty. Far better, they say, to issue emergency housing vouchers to displaced families so that they can rent from the private sector. There are supposedly 1m rental vacancies in the area at less than $700 a month. Paul Sarbanes, a Democratic senator, has already introduced legislation to get such vouchers to all Katrina refugees.

Facing the risks

Other legislation will be shaped by the inevitable pressure from lobby groups. The airline industry, for instance, is using Katrina as an excuse to get jet-fuel taxes suspended. This being America, legal wrangling will also colour Katrina's long-term consequences. The insurance industry is bracing for battles over whether property damage was caused by winds or floods (see article). Hurricane damage is covered by private property insurance, but since 1968 flood insurance has been provided by the government, through the National Flood Insurance Programme.

Although this insurance is both subsidised and obligatory for anyone with a federally-insured mortgage, remarkably few people in the Gulf Coast seemed to have it. In Mississippi's coastal countries, less than one in five households have flood insurance; even in New Orleans it is under half. In Mississippi, Richard Scruggs, a lawyer famous for taking on the tobacco industry, has already asked the state's attorney-general to challenge private insurance firms' ability to exclude flood insurance on the grounds that this exclusion is “unconscionable”.

So far, Congress has focused on giving the flood-insurance programme more money. The likely pay-outs to those who have flood insurance are around $10 billion but the federal plan has only about $1 billion of reserves. On September 12th, Congress raised the amount the flood plan could borrow to $3.5 billion. That figure will surely go higher still; and there is also the potential cost of helping both the uninsured and the underinsured—through subsidised loans and the like—to rebuild their homes and businesses.

In theory, Mr Bush could use this opportunity to reform the system and reduce the extent to which Uncle Sam subsidises people living in disaster-prone areas. But raising premiums and making insurance mandatory are both unpopular. So neither is likely to be championed by a president whose main goal is to get Katrina behind him as quickly as possible.

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New Orleans

On the mend, but changed forever

Sep 15th 2005 | BATON ROUGE AND NEW ORLEANS
From The Economist print edition

As the floodwaters recede, a struggle for the city's soul is about to begin

AFTER boarding up their windows and just before they fled, many New Orleans shopkeepers paused to write “Looters will be shot” on their premises. Some felt more detail was required. Painted on the front of Oriental Rugs on St Charles Avenue are the words: “Don't try. I am sleeping inside with a big dog, an ugly woman, two shotguns and a claw hammer.” To the right is an update, added a few days later in the same hand: “Still here. Woman left Fri. Cooking a pot of dog gumbo.”

The fear has now gone. New Orleans is safe enough for businessfolk to come back and start figuring out how to revive their businesses—the road blocks began letting them through on September 12th. The city is even safe enough for George Bush to drive around in an open-topped vehicle, as he did that same day. Of course, as a secret service agent told the *Times-Picayune*, a local paper, “we don't normally cruise through American cities that have been virtually emptied of people.”

New Orleans looks like a half-sunken pleasure boat, with rescue helicopters buzzing overhead and paramedics rapping on sodden doors in search of needy survivors. They don't expect to find many more. By mid-week, only a few dozen were being evacuated daily. The official death toll for Katrina was 711 (474 in Louisiana) on September 14th, far less than the 10,000 that Mayor Ray Nagin once predicted, but certain to rise as the waters recede and more bodies are found.

The troops may have arrived late, but they are now in full control. Humvees and sweaty foot patrols are so thick on the ground that the submachinegun-toting private security guards outside the swankier hotels seem redundant. The shooting hasn't quite stopped. “As the waters move back, [the looters] can get to more places,” says a lieutenant of the 162nd Infantry. But with soldiers empowered to detain practically anyone, most criminals have decided to lie low.

A plan to force the most stubborn residents to evacuate at gunpoint has been dropped. Most gave up when they ran out of drinking water, and the last hold-outs are mostly harmless. Some stayed rather than abandon their pets, which are barred from evacuee shelters. Others stayed out of concern for their fellow human beings. David Spielman, for example, a freelance photographer in the Garden district, says he stuck around to look after a group of nuns too frail to move.

The city is a fearful mess. Houses have burst open, cars lie crushed under trees and boats lie grounded on Canal Street. Jazz has given way to the buzz of helicopters; the scent of deep-fried seafood to raw sewage. But hordes of public employees, private firms and volunteers are cleaning up New Orleans.

The Army Corps of Engineers estimates that the city will be dry by October 8th. The port and the airport re-opened this week. And if tests find the air breathable, Mayor Nagin said people might be allowed back into the least-affected areas, at least during daylight hours, as early as September 19th.

That would include the French Quarter, where Finis Shelnutt has been guarding a building he owns since the hurricane hit. There's a restaurant on the ground floor, a piano bar above and caged doves watching Mr Shelnutt sip sparkling wine at a table on the sidewalk.

“Just got my phone charged, thank God,” he says. His taps are running again, albeit at low pressure, and the looters left him alone because “I have a very large gun.” He marvels at the senselessness of the plunder that followed the deluge. “I saw a girl stealing Mardi Gras beads. What's the point of that? They throw them at you for free during Mardi Gras.”

Tensions have eased between local and federal governments. Mayor Nagin has calmed down and stopped denouncing the Bush administration. He and Kathleen Blanco, the governor of Louisiana, toured the city with Mr Bush on Monday, ducking downed power lines in unison.

The storm's most dramatic political effects could turn out to be local. It has seriously aggravated race relations in New Orleans. Blacks tell pollsters that they are mad at Mr Bush for the slow federal response. Whites are more inclined to blame the looters, the thugs who shot at rescue boats and Mayor Nagin, who is black. A drunk white householder asks a rhetorical question: “Can you name a country run by blacks that is an example to others?” When your correspondent suggests Botswana, he roars: “Get off my property!”

Two thirds of New Orleans' registered voters are black. But the floods could change the city's racial mix. Those who lived in the worst-affected areas were typically poor, black and renting. They are now dispersed, some as far afield as Montana. They have no assets to tie them to New Orleans. Many will find work in Texas or Mississippi before their neighbourhoods are habitable again. No one knows how many will come back.

Sotto voce, Democrats fret that a loss of black voters could end their grip on the city, and perhaps even tip the tight race for the governorship of Louisiana. Ernest Johnson, head of the Louisiana arm of the National Association for the Advancement of Coloured People, promised this week to organise displaced blacks to make sure they can vote back home.

But what if they make a new home out-of-state? Never mind the politics, that could change the city's soul. Some people are unruffled by that prospect. Mr Shelnutt, the landlord, hopes developers will tear down the slums, replace them with “traditional New Orleans-style houses” and put golf courses on the low-lying land. “This could be the greatest city in the United States,” he says, adding that he hopes Donald Trump will build condos here.

Doubtless, New Orleans will change, but perhaps not that much. Frank Toussaint, a roofer from a public-housing project in the city's third ward, is one of many evacuees who long to return. From a relief centre in Baton Rouge, where he fled with his family when the waters reached waist-high, he counts his hometown's attractions. “I was born there. I've been there all my life.” And when he gets back, there will be “plenty of roofing work”.

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California's precautions

Getting ready for the Big One

Sep 15th 2005 | LOS ANGELES
From The Economist print edition

California looks better prepared than Louisiana was; and so it needs to be

EARTHQUAKES, wildfires, floods and mudslides: by almost any criterion California, the nation's most populous state, is also its most vulnerable to natural disaster. And perhaps to man-made disaster, too: Los Angeles Airport, the Los Angeles-Long Beach port complex, San Francisco's Golden Gate and Bay bridges and Disneyland are all targets for terrorists.

This week, when most of Los Angeles suddenly suffered an electricity blackout, the immediate fear was al-Qaeda. That was misplaced, but it raised an obvious question: faced by a massive disaster, how well would California cope?

It is frighteningly easy to give an alarming answer. The Southern California Earthquake Centre reckons that there is an 80% to 90% chance of a tremor of seven or higher on the Richter scale hitting Los Angeles within the next 20 years. According to the US Geological Survey, an earthquake of that magnitude would kill up to 18,000 in Los Angeles; in San Francisco, a repeat of the 1906 earthquake might kill 5,800 (almost double the last Big One). Six in ten Californians live in areas of high earthquake risk; in Los Angeles County, just about everybody does.

Almost as worrying to the planners, the pipelines and aqueducts that bring natural gas and water from northern California to Los Angeles and San Diego run south across the San Andreas and other fault lines. Meanwhile, one respected geologist says there is a two-in-three chance in the next 50 years of an earthquake or flood breaching the levees in the Sacramento-San Joaquin delta, with disastrous consequences for California's agriculture.

So how effectively have the planners planned? The verdict is mixed. Following the 1994 Northridge earthquake, which killed 57 people in the Los Angeles region, California's hospitals were required by law to retrofit their buildings by 2008 to withstand major tremors; yet some 78% of them have at least one building still at risk and many are getting an extended deadline of 2013. Similarly, some 7,500 school buildings built before 1978 have yet to be brought up to standard.

On the other hand, a lot has been done, especially in earthquake-proofing the freeway network. The Southern California Gas Company claims its system, which it has been upgrading for several years, can withstand strong tremors; the Los Angeles Department of Water and Power says it could double its groundwater pumping if pipeline supplies were disrupted.

Perhaps more important, the Californian authorities, unlike foundering Louisiana, have had plenty of “disaster practice”. There have been around 70 state-declared emergencies since 1970 in Los Angeles County, and 30 in both Orange County and San Diego County. Back in 1994, Governor Pete Wilson got the vital I-10 freeway, smashed asunder by the Northridge earthquake, repaired within 66 days by giving private contractors a mix of incentives and penalties—compared with an expected time of more than two years.

But however well managed, any disaster is bound to be costly. One calculation of “the Big One”

hitting Los Angeles is damage of more than $250 billion. Mr Wilson reckons that as far back as 1994 the cost of the I-10 being closed was a hefty $600,000 a day. Floods, too, rack up the bills: the Office of Emergency Services says the floods of January and February 1995 cost almost $2 billion; in January 1997 floods caused damage of $1.8 billion.

Who would pick up the tab? So-called “recovery programmes” are available from public funds, with FEMA providing 75%, the state 18.75% and local authorities 6.25%. But the true safety-net for the individual is insurance—and it is remarkable how few households in earthquake-prone California carry earthquake insurance. By law, it must be offered along with homeowner's insurance, but insurers reckon no more than a fifth of householders take up the offer. Even the most basic earthquake cover costs an average of $2.79 for each $1,000 of coverage, plus a 15% deductible. Given California's soaring house prices, most homeowners think that cost is too high.

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The Weekly Standard

The neocon bible

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From The Economist print edition

How to lose money and influence people

IN “Hereditary Genius” (1869) Francis Galton argued that “natural abilities are derived by inheritance”. The British psychologist's undemocratic view seems oddly appropriate to modern America. Look at the Bushes and Kennedys in politics, the Earnhardts in NASCAR racing—and the Kristols in opinion journalism.

Irving Kristol steered a succession of magazines that helped to shape neo-conservatism: *Encounter*, the *Public Interest* and the *National Interest*. Ten years ago, his son, Bill, persuaded Rupert Murdoch to put up the cash to set up the *Weekly Standard*.

The omens were not good: it was very nearly called the *American Standard* (until Mr Kristol realised that this name adorns most American urinals). And its launch was overshadowed by another rather sexier start-up, John Kennedy's *George* (which had Cindy Crawford, not Newt Gingrich, on its cover). But the *Standard* now has a political clout in conservative America out of all proportion to its 80,000 circulation. Dick Cheney gets his biked round a day before its publication date. By contrast, *George* lasted only five years.

Why has it succeeded? One reason is Mr Murdoch, who continues to support a loss-making publication for ideological reasons (“our budget is a rounding error in the News Corporation empire” claims Mr Kristol). Another reason is a relative decline in the intellectual feistiness of the main conservative organ, the *National Review*, some of whose articles read as if they were dictated by Tom DeLay's office.

The *Standard* appeared just as the Republicans were getting used to running Congress—and discovering they had to run government rather than just protest against it. It has attacked George Bush's overspending and the crony-capitalism of K-street lobbyists. But it also thinks government can be used for conservative purposes—such as promoting the family.

Many old-line conservatives couldn't conceal their dislike of pointy-headed thinkers from hoity-toity east-coast cities like Boston and New York. The *Standard* is stuffed full of them. It is the mouthpiece of a new, self-confident conservative intellectual establishment that doesn't think its feuds with Harvard professors should bleed into a distrust of higher learning.

The old-line conservative movement had an almost Marxist obsession with driving people who didn't toe the party line out of the movement. The *Standard* is more eclectic. Its intellectual godfathers include not just conservatives like Leo Strauss and Harvey Mansfield but also tough-minded liberals such as Daniel Patrick Moynihan and Scoop Jackson. In 2000 Mr Kristol vigorously supported John McCain; his executive editor, Fred Barnes, championed Mr Bush.

To the magazine's critics this “heterodoxy” is just a smokescreen for a sinister orthodoxy—neo-conservatism. The magazine has been Washington's noisiest champion of an assertive foreign policy that tries to link American power with American ideals (Mr Kristol calls it “neo-Reaganism”).

And there is no shortage of material for conspiracy theorists who want to show the Iraq war was a Zionist plot. Mr Kristol is a “semi-serious Jew” who is close to Paul Wolfowitz. He is also the head of the Project for the New American Century, which has wanted to oust Saddam for years. The *Standard* shares a building with the American Enterprise Institute, a right-wing think-tank which lists Mr Cheney's wife as a scholar.

Mr Kristol replies that neo-conservatism was more of a predisposition that shaped the magazine's response to events such as the genocide in Bosnia, rather than a pre-cooked ideology. He also points out that for most of its brief history he has been one of only two Jews on a staff of 28—a rather low proportion by the standards of American newsrooms.

Can it keep going? The shambles in Iraq has dealt a severe blow to the neocons. But the world's only superpower will doubtless discover other entanglements; and the Republicans will not stop feuding over how much government they want. The *Standard* will still have plenty to write about—provided, of course, that Mr Murdoch keeps picking up the bills.

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The Roberts hearings

Perfect Peter

Sep 15th 2005 | WASHINGTON, DC
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The nominee pleases almost everybody

Reuters

Trust me, I'm a lawyer

ONE of the surest ways to guarantee high drama in Washington is to nominate a conservative to the Supreme Court. In 1987, Robert Bork's confirmation hearings gave the world a new word—"Borking". In 1991, Clarence Thomas complained of an "electronic lynching". John Roberts is a candidate not just for a seat on the court but for chief justice. But his appearance before the Senate Judiciary Committee was about as dramatic as a *kabuki* play.

The Democrats tried their best to reveal the fanatic behind Mr Roberts's butter-wouldn't-melt exterior. They grilled him about his views on the right to privacy (ie, abortion). They reminded him of memos that he had written as a young lawyer for the Reagan administration—particularly one in which he talked of the "so-called" right to privacy. Arlen Specter, a rare pro-choice Republican, held up a huge sign to illustrate that *Roe v Wade* is not just a precedent but a "super-duper precedent". Ted Kennedy gave his usual impression of an about-to-explode volcano.

But Mr Roberts—alarmingly similar to Perfect Peter in the "Horrid Henry" books—remained preternaturally composed. He even brought his perfect family along with him, his son wearing a bow tie and his daughter with a huge bow in her hair. Facing his inquisitors, he hit all the right notes. Judges should be modest, he said (a signal to conservatives that he doesn't believe in judicial activism). But they should also believe in precedent (a signal to liberals that he won't take a scythe to activist decisions).

He made skilful use of the Ruth Bader Ginsburg gambit—refusing to answer questions on specific subjects that might come before him on the bench. He also handled the abortion issue well. He made enough conciliatory comments on the right to privacy and the importance of respecting precedents to allow centrist Democrats to vote "aye". He also insisted that there is nothing wrong with judges changing their minds. But he avoided a right-wing backlash by refusing to say whether the right to privacy extends to abortion.

Russ Feingold, a Democratic senator, forcefully pointed out that "this is a confirmation proceeding, not a coronation". But a coronation was what it looked like.

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Sex, drugs and the rural poor

A Montanan parable

Sep 15th 2005 | KALISPELL, MONTANA
From The Economist print edition

A businessman lost to a mire of colliding addictions

AP

Dasen lost his way

WHEN the police arrested Kalispell's most prominent philanthropist, Dick Dasen, in a prostitution sting at a cheap motel in 2004, many locals were furious with the cops for using a lapse of self control to wreck a good man's reputation. The town's police chief, Frank Garner, insisted there was more—and there was.

On September 12th, Mr Dasen was sentenced to jail for 20 years, though all but two years of that will be suspended providing he undergoes treatment. In May he was found guilty on six prostitution-related charges, having spent more than $3m building up a personal vice-ring of local women and girls.

Mr Dasen, who came to Flathead Valley in 1968, was an economic dynamo. He built one of Kalispell's first convention centres, owned two banks and helped modernise a local ski resort. He also spent plenty of time helping local down-and-outs through his own charity, Christian Financial Counselling. It was this which introduced him to lots of young women in the Flathead Valley who were struggling with debt, single motherhood, poverty and, especially, drug abuse.

Like many other poor rural communities, the Flathead Valley has been ravaged by methamphetamine. Much of the “speed” is produced locally (in the same way that moonshine whisky once was). Crimes related to the spread of meth have risen fivefold in the valley over the past five years. Half the women being sent to Montana's prisons are meth-users.

Mr Dasen, a staunch conservative, never used illegal drugs himself; but the women he used did. So much of the cash he gave them was spent on meth that Kalispell, a town of just 15,000 people, experienced a surge in addiction unusual even for Montana. Drug-squad officers began hearing about Mr Dasen from outraged family members, boyfriends, and from the women themselves, whom he would “cut-off” from the flow of cash for infractions. The police set up a sting with a young single mother who was behind on her payments to one of Mr Dasen's companies.

Throughout his trial, Mr Dasen maintained that his well-known generosity had been exploited by drug fiends. The jury found him innocent of seven of the charges, including one involving underage girls. But the prosecutors convinced the jury that many of Mr Dasen's gifts ($198,000 in the case of one woman) eventually came with strings attached.

Mr Dasen appealed the convictions, but he is plainly a broken man. His claim that he is now penniless has not stopped some of the women and girls filing civil suits against him. But his story is also a parable of the changes—both good and bad—in the rural west.

The industries that ruled the roost in Flathead County when Mr Dasen arrived—logging, sawmilling, a large aluminium plant—have collapsed. In their place have risen service businesses of the sort that Mr Dasen created. But many people who grew up with the old industries seem marooned by the demands of the new economy, and easy prey both for meth and for sexual predators, like Mr Dasen.

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United Nations reform

Better than nothing

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From The Economist print edition

But hardly

Get article background

SOON after his appointment as secretary-general of the United Nations in 1997, Kofi Annan lamented that he was being accused of failing to reform the world body in six weeks. “But what are you complaining about?” asked the Russian ambassador: “You've had more time than God.” Ah, Mr Annan quipped back, “but God had one big advantage. He worked alone without a General Assembly, a Security Council and [all] the committees.”

Recounting that anecdote to journalists in New York this week, Mr Annan sought to explain why a draft declaration on UN reform and tackling world poverty, due to be endorsed by some 150 heads of state and government at a world summit in the city on September 14th-16th, had turned into such a pale shadow of the proposals that he himself had put forward in March. “With 191 member states”, he sighed, “it's not easy to get an agreement.”

Most countries put the blame on the United States, in the form of its abrasive new ambassador, John Bolton, for insisting at the end of August on hundreds of last-minute amendments and a line-by-line renegotiation of a text most others had thought was almost settled. But a group of middle-income developing nations, including Pakistan, Cuba, Iran, Egypt, Syria and Venezuela, also came up with plenty of last-minute changes of their own. The risk of having no document at all, and thus nothing for the world's leaders to come to New York for, was averted only by marathon all-night and all-weekend talks.

The 35-page final document is not wholly devoid of substance. It calls for the creation of a Peacebuilding Commission to supervise the reconstruction of countries after wars; the replacement of the discredited UN Commission on Human Rights by a supposedly tougher Human Rights Council; the recognition of a new “responsibility to protect” peoples from genocide and other atrocities when national authorities fail to take action, including, if necessary, by force; and an “early” reform of the Security Council. Although much pared down, all these proposals have at least survived.

Others have not. Either they proved so contentious that they were omitted altogether, such as the sections on disarmament and non-proliferation and the International Criminal Court, or they were watered down to little more than empty platitudes. The important section on collective security and the use of force no longer even mentions the vexed issue of pre-emptive strikes; meanwhile the section on terrorism condemns it “in all its forms and manifestations, committed by whomever, wherever and for whatever purposes”, but fails to provide the clear definition the Americans wanted.

Both Mr Annan and, more surprisingly, George Bush have nevertheless sought to put a good face on things, with Mr Annan describing the summit document as “an important step forward” and Mr Bush saying the UN had taken “the first steps” towards reform. Mr Annan and Mr Bolton are

determined to go a lot further. It is now up to the General Assembly to flesh out the document's skeleton proposals and propose new ones. But its chances of success appear slim.

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Lexington

The ice storm

Sep 15th 2005
From The Economist print edition

Katrina has probably frozen politics, not changed it

FOUR years ago, September 11th shook American politics to its foundations. It not only turbo-charged the presidency and shifted the balance of power yet more to the Republicans. It also affected deep-seated attitudes to government, as Dick Cheney sensed: “One thing that's changed so much since September 11th is the extent to which people do trust the government—big shift—and value it, and have higher expectations for what we can do.”

Will Hurricane Katrina produce an equally big shift? Harry Reid, the Democratic leader in the Senate, thinks that Katrina “changed the future. Enough is enough. No more Bush business-as-usual.” Commentators from left and right have pointed out that, a century ago, natural disasters helped to launch the Progressive movement. But the truth is that, as far as politics is concerned, Katrina is an ice storm not a hurricane—freezing politics in pre-existing patterns, rather than tossing things into the air.

Katrina has undoubtedly depleted the president's political capital. Mr Bush was already in trouble before the storm: since 1945 only one second-term president, Richard Nixon, has seen a sharper rise in his disapproval ratings. The hurricane is making things worse. The number of people who think that the administration had no clear plan to deal with the disaster is growing (from 55% on September 2nd to 63% on September 11th). And Mr Bush's critics feel more strongly than his defenders: 39% strongly disapprove, compared with only 24% who strongly approve. As for independent voters, they are almost twice as likely to disapprove of his performance as to approve of it.

Katrina has blown away two of Mr Bush's strongest selling points: that he is a take-charge kind of guy and that he has made the country safer. How can the “MBA president” tout his managerial competence when he has stuffed the Federal Emergency Management Agency with cronies? (Five of FEMA's eight top employees had no experience of handling disasters when they were appointed.) And how can he claim to have made the country safer when a long-predicted disaster turned New Orleans into something out of “Heart of Darkness”?

For all that, Mr Bush can rely on three political safety nets. The most obvious is that, in this age of instant news, first impressions don't necessarily last. Mr Bush is at last getting his act together. He accepted blame for the federal government's failures and visited New Orleans. Another visit and a national address, perhaps announcing a “reconstruction tsar”, were due later this week. Meanwhile, some of the direst predictions of Katrina's effect in terms of casualties are proving to be ill founded.

The second safety net is the dismal performance of local Democrats. Louisiana's governor, Kathleen Blanco, was tardy in removing bureaucratic restrictions that prevented out-of-state doctors from working in her state. Mayor Ray Nagin failed to deal with widely discussed flaws in New Orleans's evacuation plan.

The third safety net is partisanship: faithful Republicans and Democrats witnessed different catastrophes in the Gulf. Most Republicans still approve of Mr Bush's performance. Indeed, the fact that one American in four “strongly approves” of his actions over Katrina suggests that nothing short of evidence of treason can turn diehard conservatives against this president—if that.

The partisan divide also means that the White House has few incentives to change “Bush business-as-usual”. Yes, he must devote his political capital to reforming homeland security rather than reforming Social Security, but pension reform was a dead duck before Katrina. Yes, he will have to blow as much as $200 billion on rebuilding the Gulf coast, but he hardly had a reputation for fiscal frugality. Mr Bush now has even more reasons to pander to the people who are keeping him from political free-fall: hard-core Republicans. The chances that he will nominate a conservative judge to replace Sandra Day O'Connor—probably Priscilla Owen—are higher than ever.

What about the broader balance of power in Washington, DC? Talk of an ever-expanding Republican majority—bringing in blacks, for instance—now looks dated. But the fact that the Republicans can no longer advance does not mean they are now in retreat. The mid-term elections are more than a year away, and the Republicans have plenty of arrows in their quiver. Many congressional races are still decided by local factors. House races are rigged in favour of incumbents, while the Democrats are defending more Senate seats than the Republicans (18 compared with 15). And Katrina poses problems for the Democrats, too. If they criticise Mr Bush for throwing money at the problem, they may come across as mean-spirited; if they criticise the president for not spending enough money, they risk their reputation for fiscal responsibility; and if they play the Iraq card, they probably split their own party.

The limited charm of big government

The hurricane is even less likely to revolutionise the ideological debate about the role of government. Everybody agrees that America needs more “efficient government”, of course; and everybody agrees that it needs to clarify the division of power between federal and state government. But that hardly constitutes a philosophical revolution, not least because small-government conservatives already claim Katrina as an indictment of government power rather than an open-and-shut case for more of it. Look, for instance, at the private sector's efficiency: all but 15 of the 126 Wal-Mart facilities shut down by Katrina are up and running. Surely the way to rebuild New Orleans is not yet more pork, but lighter taxes and fewer regulations?

If this argument sounds familiar, then that is indicative. Sometimes great catastrophes shake up everything they touch. But they can also just produce muddle and confusion—and then reinforce long-standing divisions. In political terms, Katrina is more likely to be a mould-freezer than a mould-breaker.

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Correction: Hawaii

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We added insult to injury by illustrating our critical article about Senator Daniel Akaka's attempt to win self governance for native Hawaiians ("Sun, surf and secession", September 3rd) with a picture of dancers in Hawaii, who in fact were visiting Maoris from New Zealand. Apologies to all concerned. The picture was removed from the online version of the article. A vote on Mr Akaka's bill in the Senate has been delayed.

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Poverty in Latin America

New thinking about an old problem

Sep 15th 2005 | APAN, MEXICO AND OCARA, BRAZIL
From The Economist print edition

Cash transfers, with strings attached, are a better way of helping the poor than many previous social programmes, as experience in Brazil and Mexico shows

PLENTY is a seasonal crop in Ocara, a parched district of Ceará, a state in Brazil's north-east. Most of its inhabitants piece together a living from odd jobs and family gardens until September, when the annual harvest of cashew nuts brings relief like a long-awaited rain. Recently, the contrast between fat months and lean ones has become less marked, for Ocara's poorest citizens are now drawing a year-round stipend from the government. It is not much, 120 reais ($52) a month at most for a family of five or more. But for Maria Rita Albino da Silva, a “farmer” and cheerful mother of two, it makes the difference between too little food and enough.

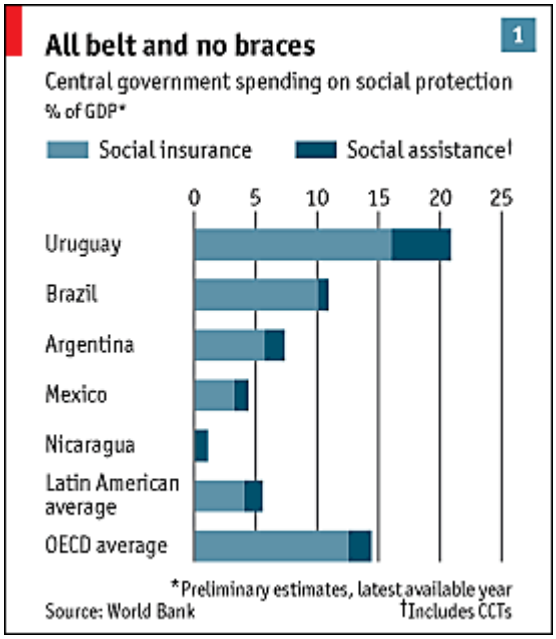
Mrs da Silva, along with most of Ocara's population, is a beneficiary of *Bolsa Família* (“family fund”), a scheme set up in 2003 that provides a basic income to 7.5m of Brazil's poorest families, or 30m people. The goal is to reach all with a monthly income per head of less than 100 reais—11.2m families, or about a quarter of the population—by the end of next year. The success of *Bolsa Família* is almost as vital to Brazil's left-wing president, Luiz Inácio Lula da Silva, as the cash is to Mrs da Silva (no relation). Lula, himself born poor in the north-east, casts himself as a crusader against poverty and corruption. But his government is mired in a party-financing scandal and its first stab at fighting poverty was “Zero Hunger”, a feeding programme ridiculed as outmoded and inefficient. *Bolsa Família*, officially part of Zero Hunger, is a chance for redemption.

It is the biggest of a new generation of social programmes across Latin America, known as “conditional cash transfer” schemes (CCTs). The aim is to alleviate today's poverty, in Brazil's case by transferring up to 95 reais a month to poor families (which states and districts can top up, as Ceará does), and to short-circuit tomorrow's, by making the transfers conditional: beneficiaries must have their children vaccinated, and their health monitored, and keep them in school.

Although CCTs are a Brazilian invention, the first large-scale programme began in Mexico. Originally called *Progresa* and now *Oportunidades*, it now provides government cash transfers to 5m Mexican families, or nearly a quarter of the population. As in Brazil, there are conditions attached. The payments are made every two months, to female heads of household. One element, of around $10 per month, is to help with food. A larger element is to help buy school supplies and pay for transport to and from school. If a child misses more than 15% of class days, or fails a grade twice, these payments are suspended. The payments are also made conditional on the family's regular visits to health clinics.

Spending better on the poor

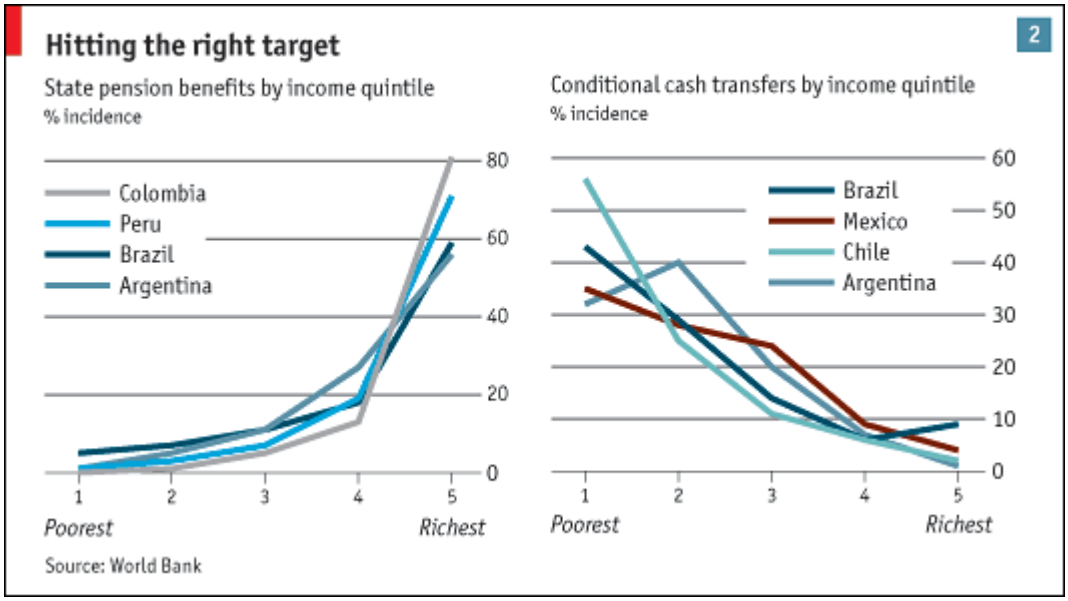
Similar schemes now exist in half a dozen Latin American countries, though the details vary. For example, Argentina's programme, expanded to cope with mass unemployment that followed the economy's collapse in 2001-02, has fewer conditions, higher benefits and has been in part sub-contracted to political leaders. By contrast, the Chilean scheme is the only one to focus specifically on the very poorest, and involves much input from social workers who try to ensure that beneficiaries make use of a range of social programmes.



Some Latin American governments spend too little to make any serious dent in poverty and social disadvantage (Brazil and Uruguay are exceptions). Worse, most of what they have spent has been on social insurance (see chart 1). This goes disproportionately to the better off. Compared even with most social assistance schemes, the CCTs are much more closely targeted to the poor (see chart 2). They are not confined to those with formal-sector jobs, which would largely exclude the poor, says Kathy Lindert of the World Bank. The fiscal cost is relatively modest: Brazil's *Bolsa Família* costs the federal government 0.36% of GDP, far less than social insurance schemes. Not only do the poor get cash, but an incentive to use government services. Prior to *Oportunidades*, says John Scott of CIDE, a university in Mexico City, it was the middle class that would take advantage of health services, rather than the poor. Now poor people go to the doctor more than in the past.

Traditionally, too, each government in Latin America has torn up its predecessor's social programmes. No longer. In Mexico, when Vicente Fox's government took office in 2000, its

officials were sceptical of *Progresa*, which covered 2m rural families that year. But the politicians were convinced by the technocrats—whom Gladys López Acevedo of the World Bank describes as exceptionally skilled. The programme not only survived, but was expanded, both to urban areas and in size. This new social safety-net has thus been "successfully institutionalised", as Ms López Acevedo notes.



In Brazil, when Lula took office in 2003 he inherited a clutch of CCTs spread across various ministries, with different lists of beneficiaries and conditions. His accomplishment has been to turn these into a single, expanded programme while improving their quality. "We didn't start from zero," says Patrus Ananias, the minister of social development, giving the previous government more credit than is customary among Lula's officials. "We integrated and consolidated" the earlier CCTs and pushed up the value of the benefit.

The success of the new schemes turns on effective administration. In Mexico, a visit to a government office is normally a far from efficient process. Simple tasks, like getting a driving licence, can take hours in apparently overstaffed offices. By contrast, in an *Oportunidades* regional office in Apan, a town of 40,000 people in the state of Hidalgo, it takes less than ten seconds for each woman in a queue which snakes out into the street to pick up her allotment of cash. Communities line up in turn. As names are called, each woman appears before the window with an identity card and a difficult-to-forge holographic stamp. All this would have been impossible without computerisation, notes Rodrigo García-Verdú, a researcher at Mexico's central bank. The ability to crunch numbers on a massive scale, he says, is part of what has allowed the programme to be better than any previous social spending in reaching the people it is intended to reach. It also has made it possible to evaluate the effects.

From confusion to consolidation

In Brazil—whose unruly federal structure encompasses 5,561 autonomous municipal districts, ranging from rural outposts like Ocara to the metropolis of São Paulo—setting up *Bolsa Família* has been far from simple. At first Lula produced confusion rather than consolidation. He created two anti-poverty ministries and yet another CCT. Under a storm of criticism, the government rethought. Four CCTs were merged into *Bolsa Família* (a fifth is soon to join). Mr Ananias's ministry was created to run it, replacing the two stillborn ministries. The transition, unsurprisingly,

was “chaotic”, says an official involved. Quality control was forgotten. Government auditors and the media found fraud in the distribution of benefits and laxity in the monitoring of conditions. With millions of beneficiaries joining the rolls and benefits tripling to an average of 65 reais, *Bolsa Família* looked like a blatant bid for popularity rather than serious social policy.

With a new team of career bureaucrats in charge and advice from the World Bank, which is lending $572m to help expand and improve the programme, *Bolsa Família* is righting itself. That means fine-tuning an elaborate system in which federal agencies, municipalities, NGOs and the beneficiaries themselves all play a part.

The task starts with accurate targeting and identification of the beneficiaries. At a church hall in Ocara on a recent Friday the pews were filled with women. They came to enrol in the “single registry” of potential beneficiaries, which replaces the separate rolls of earlier schemes. Three registrars hired by the municipality asked each of the women their family incomes and details such as whether or not their houses had plumbing. But it is the ministry in Brasília that will decide which of them deserves *Bolsa Família*. As in Mexico, women are preferred because they are more likely than their husbands to spend the money on their children. Those who qualify draw benefits from the local branch of a government bank through an electronic card.

With a single registry of potential beneficiaries, the government can check them against its data on employees in the formal sector of the economy. That exercise, conducted for the first time this year, will result in 50,000 people losing their benefits, says Rosani Cunha, who manages *Bolsa Família*. District quotas for beneficiaries, which fostered favouritism, have been dropped; now anyone below a certain income level can register, though they may not qualify for a benefit. Under new contracts with the federal government, municipalities must establish “social councils” composed of local officials and representatives of NGOs to monitor implementation. They will also gain more leeway to block and unblock benefits. Municipalities will get federal money to keep the register up to date.

Incentives and evaluations

The government is driving a harder bargain with beneficiaries, as well. An earlier programme, *Bolsa Escola*, offered families 15 reais per child for keeping up to three children in school; now all of a family's children must attend classes. Under *Bolsa Escola*, just 19% of schools reported that children from beneficiary families were regularly attending classes; now 79% do, according to Ms Cunha. The ministry is readying a scale of sanctions, culminating in the total withdrawal of benefits, to promote compliance.

Another advantage of *Bolsa Família*, say its boosters, is that objective criteria for conceding benefits are supplanting what Brazilians call “clientelism”—the doling out of favours by local potentates in return for political loyalty. In Ocara, these claims ring true, partly because the long-time mayor, who had governed for most of the district's 19-year history, lost an election last year. According to the local manager of *Bolsa Família*, Maria de Sousa Brasil, the re-registration at the church hall will weed out the 20-30% of beneficiaries who were enrolled undeservedly by the old regime.

The evidence from Mexico, where more evaluation has been done, is that CCTs do work. A June 2004 paper in the Journal of the American Medical Association found improvements in the size and health of children participating in the programme. Drop-out rates among secondary-school students are also down—by roughly 5% for boys and 8% for girls, according to a study by Paul Schultz of Yale University. That may be an underestimate: a simulation done by Jere Behrman and his colleagues at the Penn Institute for Economic Research in Philadelphia suggests that *Oportunidades* could increase secondary-school enrolment by 19%.

On their own, the cash-transfer schemes can alleviate but not abolish poverty. Even *Oportunidades* does not reach the poorest of Mexico's rural poor, who live in communities so small that they do not have schools or health clinics within reach—a number that Mr Scott estimates at 500,000 people. Secondly, getting more children to attend school is only as effective as the schools themselves. Mexico spends a fairly large percentage of GDP on education, but its students still lag badly on standardised tests. The same goes for Brazil. Schools that Ocara's education secretary calls “apathetic” are unlikely to teach much, even if students stay until age 15, as *Bolsa Família* requires.

Thirdly, cash transfers might generate some jobs, but in Ocara locals say that employment will come only when water does, and that depends on investment by the hard-pressed federal government. Indeed, according to Ms de Sousa Brasil, some beneficiaries stop working entirely, content to live off the benefit, meagre though it is. Avoiding such dependence will require further changes to *Bolsa Família*. There is talk of “complementary programmes” to shepherd people into productive work, a strong point of Chile's programme. Teenagers could get bonuses for graduating from school, as they do in Mexico, rather than dropping out after their benefits expire, as happens now. There is more to be done in co-ordinating federal, state and local programmes. It will be a long time before Ocara blooms year-round. But a start has been made.

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Chile

Democratic at last

Sep 15th 2005 | SANTIAGO
From The Economist print edition

Cleaning up the constitution

Get article background

THIS weekend, Chileans celebrate their country's independence from Spain in 1810. They will also celebrate another sort of freedom—from the last vestiges of the 1973-1990 dictatorship of General Augusto Pinochet. On September 17th, President Ricardo Lagos is due to sign a reform of Chile's constitution, deleting what he calls the “authoritarian enclaves” left in place by the dictatorship in a bid to perpetuate the armed forces' political power after civilian government was restored.

The reform, approved by Congress last month, allows the president to fire the armed forces' commanders. The National Security Council, a military-dominated body, has been stripped of all but advisory powers and can now be convened only by the president. Nine appointed senators, who include four former military commanders, will not be replaced when their eight-year term ends in March.

The enclaves from the past had long irritated the centre-left coalition called the Concertación which has governed Chile since 1990. The armed forces and their supporters on the right lost much of their previous appetite for defending these powers after General Pinochet was arrested in London on human-rights charges in 1998.

That made reform possible. But the opposition held out against the government's desire to reform an electoral system under which both houses of Congress are elected in two-member constituencies, with the coalition that comes second needing only a third of the vote to secure one of the two seats. In most constituencies, the Concertación and the opposition each wins one seat. The effect, points out Patricio Navia, a political scientist, is that the parties choose who gets into Congress and have an “insurance policy against defeat”. Under the reform, the electoral system is no longer written into the constitution, making it easier to change in future.

Michelle Bachelet, the Concertación's candidate in a presidential election in December, wants to do that. But the presidential term is being cut from six years to four. The aim is that elections for president and Congress will coincide. It means that Ms Bachelet, if she wins, will have less time to enact difficult reforms. But the opposition's divisions—it has two rival presidential candidates—may weaken its showing in the Congressional election, allowing the Concertación to pick up both seats in some constituencies. In any event, from now on the politicians, not the generals, will take the big decisions, even if some Chileans feel their vote does not count for much.

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Economist.com WORLD LATIN AMERICA

Peru's trade

Ports in a storm

Sep 15th 2005 | LIMA
From The Economist print edition

A fight over privatisation

Get article background

FROM minerals to marigold meal, Peru's exports are booming. The goal set in 2001 by the government of Alejandro Toledo of doubling export revenues—to $14 billion—during its term has been met a year ahead of schedule. If talks with the United States on a free-trade agreement succeed, exports could total $30 billion by 2011, according to Alfredo Ferrero, the trade minister. But there is a big bottleneck: the woeful state of the country's ports. The government's solution is to bring in private operators. But it will not be easy.

Though other ports may also be offered to private operators, the big battle is over Callao, the port for Lima, which handles nearly 90% of the country's container traffic. It is clogged and outdated. Its main wharf lacks dockside cranes; it can only handle ships with their own cranes, a disappearing breed. Unloading is slow, adding to costs. Just bringing the port up to scratch would cost $300m; a plan to expand capacity from 13m tonnes of cargo a year to 20m tonnes with a second dock would cost an extra $700m.

These schemes have been debated for two decades. Alberto Fujimori, Peru's president from 1990-2000, only privatised Matarani, a small port in the south (which has since doubled its traffic). In 2003 Mr Toledo's government pushed through a new ports law, but has since moved slowly. Businessmen want the government to start by putting out to tender Callao's less controversial new terminal. Mr Toledo says, vaguely, that this may happen in December.

To mollify opponents, Pedro Pablo Kuczynski, the prime minister, said that ENAPU, the state-owned port operator, and private investors should jointly upgrade the main wharf. Even so, some accused him of wanting to turn the ports over to firms from Chile, a neighbour regarded by many Peruvians as arrogant. Luis Negreiros, a congressman and dockers' leader, insists that ENAPU, which made a profit of $13m last year, should modernise the main wharf itself. The dockers this week began a strike campaign against privatisation. Settling this fight may turn into a task for the next government, due to take office in July 2006. Meanwhile, some exporters may be reduced to desperate measures, such as using ports in Chile and Ecuador, or flying goods out through Lima's privatised airport.

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Economist.com WORLD ASIA

Afghanistan

A glass half full

Sep 15th 2005 | KABUL
From The Economist print edition

AFP

As Afghanistan prepares to elect its first democratic parliament for almost 40 years, the country is doing better than many feared

Get article background

ON THE campaign trail this week, Mullah Qalamudeen, the former Taliban deputy-minister for vice and virtue, was warmly welcomed in Logar province, in Afghanistan's violent east. Seated on cheap Iranian carpets in open-air mosques, he presented his manifesto to huddles of bearded elders. It was strong on values (Islam and *jihad*); thin on policy. But Mr Qalamudeen pledged that if the Islamist clauses in Afghanistan's constitution are diluted as a consequence of the parliamentary and provincial elections due on September 18th, he will take up his Kalashnikov rifle in their defence.

Mr Qalamudeen is one of the more impressive of the 5,800 candidates contesting the polls: he is not promising Logar instant roads and schools, or blaming foreigners for all Afghanistan's troubles, and he can read. Nor, unlike one or two other prospective members of parliament, did he oversee the slaughter of several hundred thousand residents of Kabul in the civil war of the 1990s. Nor does he have a private army, unlike 207 would-be candidates, according to an estimate by the local and foreign agencies that are running the election.

Only 21 of those villains have been disqualified: the government of President Hamid Karzai excused all the rest. The electoral complaints commission fielded several thousand other objections to candidates which did not make them ineligible—including charges that they had

committed appalling war crimes, and, from one sorry plaintiff, that a candidate had stolen his wife. One local warlord left in the race is Haji Almas, a well-built parliamentary hopeful for Parwan province, with plucked eyebrows and a gravelly voice, whose supporters allegedly mount illegal road-blocks and traffic in opium. “My name is well known across the country,” boasts Mr Almas, as he promises to build national unity.

The same is hoped for the elections themselves, which were originally supposed to have been held at the same time as the presidential election a year ago that returned Mr Karzai to power. By imposing an important check on presidential power, and also drawing Afghanistan's poor regions into a centre that has done little for them in recent years, they are an important stage in a trail-blazing post-war reconstruction effort; in theory, at least.

The reality is murkier. Against the advice of most of the foreign donors keeping him afloat, Mr Karzai chose the unusual single non-transferable vote system, whereby the 12m registered voters select one name (or, for illiterates, the corresponding symbol) in huge multi-member constituencies. In Kabul, 400 candidates are vying for 33 seats and the ballot runs to seven tabloid-sized pages. Voters need to look through the whole lot before making their choice, and the top 33 get the seats. With studies suggesting that illiterate women did not know how to turn pages, mistakes were expected, and voting was thought likely to proceed at a crawl. In contrast to last year's election, Afghans may vote only in their registered polling station, a fact that seems to be little-known, and could prevent many from voting at all. So could violence in the south and east, where an insurgency by Taliban and other fanatics continues: on September 13th, seven men carrying voter registration cards were murdered on a road in Uruzgan.

All this could create an opportunity for mischief by Yunus Qanuni, champion of the Tajik minority and Mr Karzai's main opponent. After coming a distant second to Mr Karzai in last year's poll, Mr Qanuni at first refused to accept defeat—and in an interview this week still claimed to have won 53% of the vote. Now vying for a place in parliament, he let it be known that unless he and his friends win half the 249 available seats he will again cry foul.

Even if serious glitches can be averted, the election should at best put in parliament a fractious rabble, with shifting factions bound by ethnicity and stealthy allegiance to the best organised political parties, most of them formerly communist. Such a body would struggle to rule on the 200-odd decrees Mr Karzai has handed down since his election, within 30 days of meeting, as the constitution seems to say that it must. The provincial assemblies will be much weaker, with no control over presidentially appointed governors—to the dismay of their would-be members, who were told this only mid-way through campaigning. Elections for local assemblies, also overdue, will not be held; due in part to the insurgency, district boundaries have not been fully demarcated.

Under the guiding hand of America, Mr Karzai's strongest ally, the electoral system was clearly designed to maintain a strong presidency. It is a strategy that could fail: Mr Karzai may find swift ad hoc support for his diktats, or he could be forced to spend distracting months negotiating to get his way. Whichever comes to pass, it seems right to ask whether Mr Karzai, a mid-level Holy Warrior against the Soviet occupation, and then an opponent of the Taliban, who has ruled Afghanistan since 2001, deserves now to find himself in such a powerful presidency.

An opportunity wasted

Last year's election gave Mr Karzai the legitimacy he had previously lacked, and the temporary freedom to rule unencumbered by parliament. Excited pro-reformers, led by the finance minister, Ashraf Ghani, urged him to seize the chance: issue a 180-day reform programme, rid himself of ineffective provincial governors and other officials and accelerate the centre's outward reach. Mr Karzai responded by sacking Mr Ghani, announcing no new reforms and carrying on as before:

ruling through slow consultation with tribal elders and the ex-mujahideen commanders who waged civil war before the Taliban sent them packing. Under pressure to remove Gul Agha Sherzai, under whose watch southern Kandahar province increased opium production by 140% this year, Mr Karzai instead recently shifted him to eastern Nangahar province, which had cut opium production by 95%.

One presidential adviser, and parliamentary candidate, causing particular concern is a former Saudi Arabian-backed jihadist leader named Abdul Rasul Sayyaf. According to a recent report by Human Rights Watch, a lobby group, he is “directly implicated in the abductions and the indiscriminate and intentional targeting of civilians”. During the war against the Soviet army, together with Osama bin Laden, he founded training camps that sent Muslim fanatics to fight in Chechnya, Bosnia and the southern Philippines—where an Islamic terrorist movement, Abu Sayyaf, is named after him. In 1996, when Mr bin Laden was ejected from his base in Sudan, Mr Sayyaf invited him back to Afghanistan. Last week, at a meeting in the presidential palace in Kabul, Mr Karzai invited Mr Sayyaf to advise him whether to reappoint the heroic boss of the Afghan Independent Human Rights Commission. Mr Sayyaf advised against it.

In his defence, Mr Karzai could argue that he has had insufficient foreign help to take on the warlords. A NATO-led peacekeeping force, currently 11,000-strong, and known as the International Security Assistance Force (ISAF), keeps an eye on northern and western Afghanistan, from where most of the warlords hail. Yet, totalling a handful of small garrisons, and with most of its European troops forbidden by their national government to do aught more muscular than dig wells, it does little to assist with security. ISAF played no role in the recent demobilising of 60,000 militiamen—many of whom are believed to have pocketed the UN's cash incentive and formed new bandit gangs. According to Major Luigi Mantoli, deputy chief of an Italian garrison in the western city of Herat: “Our military component is just for self-protection—it's a very, very light presence, a very, very, very light presence.” True enough, Herat is currently peaceful. Yet a straw poll of Heratis milling outside the city's fine blue mosque suggested that

security is their biggest concern.

According to Mr Karzai's logic, elections are no reason to risk civil strife. In defence of his caution, he can claim general progress. Last year, driven by wheat production, after decent rains ended years of drought, the economy grew by 13%. Government revenues are pathetically small—$350m last year, but growing too. Competent technocrats remain in charge of several key ministries, even if corruption beneath them is pervasive. The American-trained Afghan National Army is 30,000-strong, its desertion rates are dipping, and it provides useful support to the American-led coalition army that is fighting insurgents. And, moreover, several strongmen, notably Ismail Khan of Herat, and Rashid Dostum, an Uzbek from the north, have been co-opted into the government and so weakened.

Just so, reply Mr Karzai's critics—and their example should embolden the president. When sufficiently threatened, warlords have capitulated. Given that America and ISAF promised to take care of any troublesome disqualified candidates, the decision to disqualify so few armed men from standing for election seems an opportunity lost, especially given the rising uncertainty about how long Mr Karzai will be able to count on such assistance.

The elections probably do not amount to a genuine watershed in Afghanistan's creeping transition from abject dependency to, it is hoped, fragile self-sufficiency. Most Afghans have embraced them, but more in hope of benefits to come than jubilation at benefits received. In Pol-e-Khumri, a town in central Baghlan province, the menfolk of a destitute Pushtun family recently returned from exile in Pakistan said they would vote for any candidate who would bring them peace.

AFP

Karzai the cautious

But peace is not all that the Afghans were promised in 2001. Of four road-building projects, barely one has been completed; work on the western stretch, from Kandahar to Herat, was frozen this month after Taliban assassins tossed a British engineer over a cliff to his death. The power sector is a shambles. Private investors remain discouraged by dozens of extraneous taxes, and now a corporate tax of 20% will be introduced after the election. Even with the requisite political will, because of a shortage of technical expertise, reforming the system will take years.

In the past four years, for aid and development, Afghanistan has received around $10 billion—about the annual cost of America's military venture there. Half has come from America but, unlike the contributions from Europe and Japan, the American aid comes without any long-term guarantees. There are fears in Kabul that, next year, America will not be so forthcoming.

That would not be in America's own interest, because its first job in Afghanistan, the suppression of al-Qaeda terrorists and the local fanatics who succoured them, is still not done. This year, 69 American soldiers have been killed by these enemies, the highest number since 2001; though the figure is swollen by two serious incidents, including the shooting down in June of a helicopter carrying American special force fighters, killing 16. An improvement in the guerrillas' bomb-making skills has suggested the arrival of help from Iraq's insurgents, but media talk of a “second front” emerging in Afghanistan is unfounded. American forces in Afghanistan admit to having killed 600 people since March, though given their propensity to kill from the air, the true number is probably considerably higher.

Grim as this sounds, America has improved its military tactics. Its regular soldiers are operating

more like special forces, in smaller units, and in tandem with the eight battle-ready battalions of the Afghan army. At Mr Karzai's request, this year, restrictions have been placed on airstrikes and house searches, which has probably meant fewer civilians killed or riled. America can also expect some fresh help in its fight, with around 4,000 British and Canadian troops expected to be deployed to southern Afghanistan by early next year. Whether ISAF will take over the coalition's combat role, allowing American to withdraw several thousand troops from Afghanistan next year as it would like, remains in doubt. At a meeting of European defence ministers in Berlin on September 13th, Germany, France and Spain opposed giving NATO such extended duties.

Still, whether as NATO or as an American-led coalition, America and its allies will not be able to defeat the insurgents so long as their leaders are based not in Afghanistan but, as intelligence very strongly suggests, in next-door Pakistan. On September 12th, Pakistan's president, Pervez Musharraf, suggested building a fence along Pakistan's border with Afghanistan to prevent all illegal incursions. It would surely be cheaper to start by arresting those Taliban leaders living contentedly, and relatively openly, in Pakistan's northern town of Quetta.

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Economist.com WORLD ASIA

New Zealand

Nose to nose

Sep 15th 2005 | WELLINGTON
From The Economist print edition

A tense election with plenty at stake—especially for Maoris

Reuters

Clark reaches out

Get article background

WHEN New Zealanders go to the polls on September 17th, they will face a stark choice. The current Labour government, led by Helen Clark, is bidding for a third term with the promise of improved public services and limited tax breaks for families. The National Party, Labour's main rival, is offering much bigger tax cuts in tandem with smaller government. Most recent soundings give National a slight edge, although the two parties have see-sawed in the polls. Under New Zealand's system of proportional representation, neither is likely to win an outright majority, forcing voters to make complicated calculations about potential coalitions. For New Zealand's Maori voters, in particular, the decision will be fraught.

Traditionally, both Labour and National have taken a relatively accommodating stance toward the Maoris, who make up some 15% of the population. Over the past 20 years, during alternating spells in government, both parties have supported the work of the Waitangi Tribunal, which investigates claims of past and present abuses of indigenous rights, and recommends compensation for them. The work of the tribunal, in turn, is based on the 1840 Treaty of Waitangi, whereby some Maori chiefs ceded sovereignty to Britain in return for guarantees that their customary rights would be respected.

But the political consensus on these procedures evaporated two years ago, when a court ruled that Maori tribes could attempt to prove customary ownership of the seabed and foreshore (the bit of the coastline between the high- and low-water marks), and so potentially gain a say in the

management of the country's beaches. The media stoked fears that the ruling would put an end to seaside holidays, prompting the rattled government to pass a hastily conceived law to keep the foreshore and seabed in public hands.

Don Brash, the National Party's leader, thinks that the government did not go far enough. He wants to wrap up the work of the tribunal by 2010. Moreover, he argues that efforts to address Maori grievances are instilling a system of “racial separatism”. He wants to excise references to the Treaty of Waitangi from legislation, eliminate any special role for Maoris in planning applications and abolish the seven seats in parliament reserved for them. After all, he points out, Maoris won a further 12 out of the 113 ordinary seats at the last election, and five Maoris from National alone are likely to win seats this time around.

Many Maoris, meanwhile, think that both Labour and National take too narrow a view of indigenous rights. One Maori MP was so outraged at Labour's abolition of Maori claims to the foreshore that she quit the party, and set up the rival Maori Party. It might win as many as five of the Maori seats, and play a pivotal role in post-election coalition-building. If a National government really tried to abolish those seats, says one Maori Party candidate, it would face “an uprising”.

Yet there is some common ground between National and the Maori Party. National says it is happy to maintain funding for Maori schools and hospitals in the name of choice. The Maori Party, for its part, says that Maoris are too prone to look to the government for solutions to their problems. And both agree that compensation payments alone are not the panacea that many Maoris imagine.

Maoris lag behind other New Zealanders by almost every measure. They are poorer, less educated and less healthy. They are more likely to be unemployed, to commit suicide and to be victims of crime. Over half of prison inmates are Maori. Payouts for past abuses cannot fix all this, both National and the Maori Party contend. Instead, what is needed are better targeted welfare schemes, more efficient public services and a more buoyant economy—the very issues that non-Maori voters are focusing on.

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Economist.com WORLD ASIA

Hong Kong and China

Taking the Mickey

Sep 15th 2005 | HONG KONG
From The Economist print edition

China spins a fairy tale for Hong Kong's democrats

AP

Zeng meets mouse

Get article background

DISNEY may claim to understand show business, but the real masters of the genre are the propaganda chiefs of the Chinese Communist Party in Beijing. Just look at the recent flying visit to Hong Kong of Zeng Qinghong, China's vice-president.

Mr Zeng presided over the opening of the territory's new Disney theme park on September 12th, basking in the huge popularity that Mickey Mouse and his friends enjoy among the locals. The vice-president then looked in on the denizens of the “Cheerful Court” senior citizens home, who described him as “amiable and warm-hearted”. Then he threw a grand dinner at the Shangri-La Hotel for 400 dignitaries, including the 60 members of the Legislative Council (Legco), the territory's pseudo-parliament.

Notably, the invitation was extended to all of the “pro-democracy” members of Legco, whose existence China does not usually acknowledge—including even the outspoken “Long Hair” Leung Kwok-hung, an independent member who says he will not cut his hair until the Tiananmen massacre is accounted for and who was, predictably, ejected during dinner for making a rumpus. It also emerged during Mr Zeng's stay that the democrats, who are routinely barred from the mainland, will be allowed to travel to neighbouring Guangdong this month to meet the province's governor and party secretary—an honour indeed. The vice-president's sojourn felt more like a baby-kissing tour by an American presidential contender than the usual stiff official visitation.

The timing of this charm offensive, the first visit to the territory by Mr Zeng since the Chinese

government put him in charge of Hong Kong affairs following the huge democracy protests of July 2003, is perhaps no accident. Emily Lau, one of the more forthright of the pro-democracy Legco members, thinks the visit is firmly connected to a looming row over constitutional reform. China has ruled out full democracy any time soon, declaring in April of last year that there would be no direct election of the next chief executive in March 2007, or of the next Legco in September 2008. But the democrats are still demanding universal suffrage—and mainland policymakers fear that, despite a buoyant economy, Hong Kong's people may take to the streets again over this issue.

Against this background, Donald Tsang, who was appointed chief executive earlier this year, will next month present the fifth report of the government's constitutional reform task-force. This is expected to sidestep any real change, while throwing reform-minded legislators a few sops. Principally, it aims to create five additional indirectly-elected Legco seats, reserved for (directly-elected) district councillors, while also adding all 529 of those councillors to the Beijing-approved Election Committee that picks the chief executive. These “reforms”, which are meant to form the basis of the 2007-08 electoral law, require a two-thirds majority to pass parliament. The snag is that 25 of Legco's 60 existing seats are controlled by the democratic camp. No wonder, then, that Mr Zeng was so keen to throw a little magic dust in their eyes.

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India and America

For us, or against us?

Sep 15th 2005 | DELHI
From The Economist print edition

An Iranian spanner in the strategic-partnership works

IT WAS a short honeymoon. Just two months ago Manmohan Singh, India's prime minister, returned home triumphant from a trip to Washington, DC, which seemed to have transformed relations with America. Yet this week, as Mr Singh arrived in New York for the UN's General Assembly, the partners were trying to make up after their first tiff.

Mr Singh's prize in July was to secure America's commitment to “full civil nuclear energy co-operation” with India, even though India has built nuclear weapons and has always refused to sign the Nuclear Non-Proliferation Treaty. The deal was controversial in India, where Mr Singh was accused of giving away too much in return.

There were critics in America, too, who thought India had not given nearly enough. Now the administration is impatient, for two reasons. First, it feels it has shown good faith, by helping secure the support of other nuclear powers for the deal and by sending top officials to defend it to Congress. Yet India has not begun to meet its central commitment—the separation of civilian and military nuclear facilities, and the submission of the former to international controls.

Second, America has deep reservations about India's good relations with Iran, whose nuclear ambitions are the focus of so much concern. Just this month, Natwar Singh, India's foreign minister, visited Iran and stressed India's commitment to “continuing and expanding” ties. Some congressmen are outraged. Tom Lantos, a senior Democrat, last week launched a savage attack, describing Indian officials as “simply dense, because they are incapable of comprehending that other countries have their important concerns”.

“Nothing will fly” in Congress, he predicted, unless India showed sensitivity to American concerns. The administration, of course, is more polite. But in his meeting with Mr Singh on September 13th, George Bush pressed India over Iran; America wants Iran reported to the Security Council for its nuclear activities.

All of this bodes ill for another important issue in Indo-Iranian relations: a planned $4 billion project to pipe Iranian gas through Pakistan to India. It is a visionary scheme, seen by many as offering the hope not just of greater energy security for India and Pakistan, but of giving all three countries a huge economic stake in regional peace and stability. But it looks as if its abandonment may turn out to be part of the price America demands for its friendship.

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Angola

The long road to recovery

Sep 15th 2005 | LUANDA AND LUENA
From The Economist print edition

AFP

Three years after the end of its civil war, Africa's second-largest oil producer is still licking its wounds

Get article background

FOR Helen Cahamba, exile is finally over. The 46-year-old widow, who fled Angola in 1976, has just returned from Zambia with her seven children and four grandchildren. Back now in Luena, in Moxico province, she feels at home. Since the end of the country's 26-year civil war in 2002, over 320,000 Angolan refugees have come back, and the UN will soon stop its repatriation programme. The end of fighting has brought some improvement and great hope. But in spite of the country's vast oil and diamond riches, prosperity for most Angolans is still a distant dream.

Despite occasional violent incidents, the seeds of war seem finally to have been removed. The death in 2002 of Jonas Savimbi, who led the National Union for the Total Independence of Angola (UNITA) with an iron fist, finished off the exhausted rebel movement. About 100,000 former rebels have since been demobilised, and over a third have been helped with training or jobs. UNITA is now part of a government of national unity dominated by its former enemy, the Popular Movement for the Liberation of Angola (MPLA). Isaias Samakuva, UNITA's new leader, is working to turn the guerrilla movement into a democratic political party.

The country could take another step towards recovery next year with the first elections since 1992. No date has yet been set, and UNITA has accused the government of José Eduardo Dos Santos of dragging its feet. But the problems involved in organising a poll are daunting. About 750,000 Angolans were killed in the war and a further 5m fled, so nobody knows exactly how many people live in the country. Many have no identity documents, and most roads and bridges

are destroyed, which makes registration even harder.

Some signs of recovery are visible, though not everywhere. In Luanda, swanky office buildings are going up and informal shacks gradually being demolished as residents are relocated to new houses. The local Toyota garage reports that car sales have more than tripled since 2002. Some provincial capitals are also showing signs of improvement. But in the countryside the situation is worse. Landmines still make farming and transport hazardous, and UN food aid has been scaled back for lack of money.

The irony is that Angola, where 70% of the people live in abject poverty, is rich. With over 1m barrels extracted every day, it has become the second-largest oil producer in sub-Saharan Africa, and volumes are expected to double by 2008. Oil, which provides close to 50% of the country's GDP and over two-thirds of the government budget, has turned Angola into one of the top destinations for foreign investment in the region. It is also the world's fourth-largest producer of diamonds. The economy grew by almost 12% last year, and could do even better this year. But too little wealth trickles down to ordinary Angolans.

Much of the oil production has already been mortgaged. Angola's foreign debt now stands at about $9.5 billion—half of GDP. With only limited access to cheap borrowing, the Angolan government has turned to commercial, oil-backed debt. In 2003-04 alone, it raised $4 billion from commercial banks and bilateral credit lines against future oil revenues. Vast amounts of money have also been nabbed by a small elite, and Angola is considered one of the region's most corrupt countries.

Some within the government have been seeking more openness and reform, though it is difficult to know how far they are willing, or able, to go. But in a review of government economic policies published in July, the IMF reported progress. The budget has been unified, suggestions for reforming the oil sector published and information on oil revenues released. The budget deficit has been cut, and inflation has dropped from over 106% in 2002 to 31% last year. Still, reform has been slow, and with the price of oil at over $60 a barrel, the government has little incentive to heed advice (let alone borrow money) from outside donors such as the IMF.

It is essential, to keep Angola stable, that its wealth is shared more fairly. A rebel group fighting for independence in the oil-rich enclave of Cabinda seems to have been defeated, but a heavy-handed military presence there is alienating many. Though the region now gets more money from the government and oil companies, a general feeling of discontent is easy to tap into. A recent report also paints a grim picture of human-rights abuses in the diamond-mining Lunda provinces

in the east, where locals feel cheated and angry.

Next year, Angolans will at least have a chance to speak through the ballot box. But they may struggle to find an articulate and compelling plan for their future from either the ruling party or the opposition. Until the country's leaders are more interested in the country's welfare than their own, elections are unlikely to bring the drastic changes Angolans need so badly.

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Iraq violence

Butchery in Baghdad

Sep 15th 2005
From The Economist print edition

Al-Qaeda claims responsibility for one of Iraq's bloodiest days

AP

The remains of the day

Get article background

UNEMPLOYMENT is rife in Baghdad, with many young men waiting each morning for a chance to work as construction labourers. These Iraqis, who had hoped to play a small part in rebuilding their shattered country, bore the brunt on September 14th of the second-deadliest single terrorist attack since the toppling of Saddam Hussein.

The bombing took place in the Shia district of Kadhimiya, not far from where over 1,000 worshippers died earlier this month in a stampede. Over 100 were killed and about 400 wounded by a suicide bomber who had lured his victims towards his minivan with promises of work. The method of the attack left no doubt that inflicting maximum civilian casualties was the objective.

On the same day there were scores more deaths across Iraq as civilians, police and the American army were all targeted. In Taji, a Baghdad suburb, 17 Shias were dragged from their homes and shot in the head. In total, the day's death toll looks set to rise above 150. The timing and number of attacks suggests they may have been part of a co-ordinated assault. The next day, at least 24 policemen were killed in two more suicide bombings and there were further scattered attacks around the country.

Abu Musab al-Zarqawi, the leader of al-Qaeda in Iraq, appeared to claim responsibility, posting an announcement on a website that “the battle to avenge the Sunnis of Tal Afar has begun”. It was in the northern town of Tal Afar, near the Syrian border, that American and Iraqi army units recently attacked Sunni insurgents, claiming to have killed 157 of them and capturing 440 more. This would continue a pattern, demonstrated after the clearing of Fallujah last year, of retaliation by al-Qaeda after American and Iraqi assaults on rebel-held towns.

Another, possibly complementary, motive behind the attacks may be to damage the recently agreed draft Iraqi constitution. The referendum on the proposed constitution is set for October 15th and the Iraqi parliament has sent the document to be printed by the United Nations so that copies can be distributed to every household in Iraq. Despite recent concessions, many in the Sunni minority that ruled Iraq under Mr Hussein regard it with hostility and suspicion.

Given that the Shia majority appears to have been the target in many of the latest attacks, it is hard to rule out a sectarian motive. It is difficult to know the exact relationship between this

ongoing sectarian conflict and al-Qaeda's desire to hurt and humiliate the American-led forces in Iraq, but Mr al-Zarqawi is clearly trying to portray himself as the avenger of the Sunnis.

Whoever is responsible, the results are the same; massive bloodshed and increasing tensions between Shias and Sunnis. So far the Shia majority has been restrained from seeking significant retribution. Grand Ayatollah Ali al-Sistani has played a vital role in this, but every bomb makes his job harder. Those, such as al-Qaeda, who wish for a sectarian free-for-all, hope that with ever more bloodshed it will become impossible.

This is what the wider Arab world most fears. As one Jordanian businessman put it, “we are frightened of a new Somalia on our border.” However, it will be Iraqis, like the would-be construction workers in Baghdad this week, who will inevitably suffer most.

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Iran

On a roll

Sep 15th 2005 | TEHRAN
From The Economist print edition

Iran's confidence grows in its nuclear confrontation with the West

Get article background

TO THE uninitiated, Mahmoud Ahmadinejad's maiden speech to the UN General Assembly on September 14th was a sublime rant by Iran's hardline president against the iniquities of American foreign policy. Behind the revolutionary platitudes, however, lay an urgent, if elliptical, appeal. Four days before the governing board of the International Atomic Energy Agency (IAEA) convenes in Vienna, Mr Ahmadinejad hopes to prevail on its members to reject American (and European) efforts to have Iran's nuclear programme referred to the UN Security Council.

At midweek, Mr Ahmadinejad had yet to unveil long-awaited proposals aimed at unblocking the diplomatic impasse that Iran caused last month when, after two years of interruptions, it resumed work in preparation for enriching uranium—for use as reactor fuel, says Iran, though many governments suspect it of having bomb-making ambitions. That move prompted Britain, France and Germany to discontinue negotiations aimed at persuading the Iranians to abandon for good their ambitions to enrich uranium and make plutonium (another potential bomb ingredient). Iran has ruled out a revived suspension of work at its uranium conversion plant at Isfahan; without it, say the Europeans, there will be no more negotiations. How to explain, then, as crisis looms, the new zip—chutzpah, even—of Iran's foreign policy?

The Iranians feel more secure than at any time since the negotiations started. One American ailment, Iraq, has worsened; another, Katrina, was recently added. And Iran has been soliciting diplomatic support from powerful neighbours. Russia has been seduced by civilian contracts for its ailing nuclear industry and China by an Iranian undertaking to meet some of its energy needs over the next 30 years. Both are IAEA board members and permanent members of the Security Council; neither is likely to support an early referral.

Iran is also close to approving a deal to supply $22 billion-worth of liquefied gas to India, with more probably to follow. Both governments talk up the possibility of building a pipeline to carry Iranian gas across Pakistan to India, which hopes that, in return for helping Iran, it will be supported in its claims to a permanent seat on the Security Council.

The Iranians showed off their new assertiveness when they contemptuously rejected European incentives, even before they were presented last month, that were designed to coax them into giving up their fuel-cycle plans. It is also far from certain that they will heed a recent call by Mohamed ElBaradei, the IAEA chief, to provide inspectors with prompter access and co-operation. On the contrary, if Iran is referred to the Security Council, its parliament wants to downgrade co-operation with the IAEA.

Much depends on lobbying in New York and Vienna. But for America and its partners, a Security Council referral is far from certain. And then there is the possibility, however distant, of economic sanctions. Here, luck favours Iran.

At a time of soaring oil prices, an oil embargo or disruptions to Iran's supply of petrol—of which it buys a lot abroad—could be fraught with consequences. Iran has done without American investment and trade for years, which leaves only its biggest trading partner, the European Union. In Tehran, a senior European diplomat mulls over travel restrictions on senior Iranians, the seizure of Iranian assets and an end to the provision of credit guarantees for European companies active in Iran. He curls his lip at the suggestion of something stronger: “In general, we don't think sanctions work.”

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Iran's heritage

Cyrus the Disputed

Sep 15th 2005
From The Economist print edition

An argument about an exhibition exposes prickliness and pride

British Museum

FOR modern Iranians, few subjects are thornier than their imperial, pre-Islamic past, and few nations less trusted than Britain, their more recent, neo-colonial tormentor. So, when the British Museum in London asked Iran's government to help it stage a big exhibition on the ancient Achaemenid empire (550-330BC), Islamists and nationalists came together to denounce the plan. But the exhibition was saved, thanks to the energy of its curator and the diplomacy of Iran's ambassador to Britain. When “Forgotten Empire: the World of Ancient Persia” opened last week, some 80 artefacts lent by Iran were on display.

End of story? Not in the home of the Achaemenids. Iran's debate about distant ancestors—whose writ, at the peak of their power in around 500BC, ran from India to north Africa—rumbles on. Admired by the last shah, the Achaemenids (Cyrus and Darius among them) have been mostly disdained under the Islamic Republic. Soon after the Islamic revolution of 1979, a prominent ideologue suggested bulldozing the remains of Persepolis, the magnificent Achaemenid city that Alexander the Great razed in 331BC (and whose surviving treasures are an important part of the show). More recently, Ali Larijani, when he was head of state television (he has since become Iran's chief nuclear negotiator), lauded a purportedly scholarly book which claims the Achaemenids had no civilisation to speak of.

Muhammad-Reza Kargar, who heads Iran's National Museum, speaks for a younger generation of bureaucrats that abhors this attitude; he regards Iran's past, along with oil, as its greatest resource. And younger Iranians have reacted against an unrelenting diet of Islamic history and culture by seeking out pre-Islamic glories. But they mostly have to content themselves with reading books; many of the most glorious artefacts were sold to foreigners by 19th-century shahs looking for ways of raising money. As the exhibition's organisers stress, the Islamic Republic is not alone in traducing the ancient Persians; Greek writers such as Herodotus and Aeschylus, who naturally sided with their fellow Hellenes when describing the Greco-Persian wars, misrepresented them as barbaric and indolent. In fact, as the exhibition shows, the Achaemenids were relatively humane and their empire a marvel.

Even some Islamic hardliners seem to have absorbed this lesson. When he ran (unsuccessfully) in this summer's presidential election, one such hardliner put an image of Persepolis on his election poster. His name? Ali Larijani.

Palestinian politics

No command and less control

Sep 15th 2005 | JERUSALEM
From The Economist print edition

Political squabbling undermines security reform

AS ISRAEL pulled its last soldier out of Gaza this week, few Palestinians had time for internal politics as they made the most of freedoms they had not enjoyed in decades—overrunning the former Israeli settlements, splashing in the sea and streaming back and forth across a temporarily unguarded border with Egypt. Nonetheless, a political crisis is brewing.

This week the Palestinian Legislative Council (PLC) has been discussing the security services' performance. Uniting under one command the dozen-odd forces, which under Yasser Arafat operated almost as private fiefs, is the job of Nasser Yusuf, the interior minister. He has made some modest progress, but has endured constant sniping. And last week, after a large armed gang assassinated Musa Arafat, a cousin of the late Palestinian president, with no response from any of the security forces, there were calls for Mr Yusuf to go. The images of the looting and chaos in Gaza, with security officers standing by, have not helped him. Some PLC members want a no-confidence motion.

Among Mr Yusuf's many detractors, at least in private, are Muhammed Dahlan, the man with most of the responsibility for Gaza after the Israeli pull-out, and Jibril Rajoub, the head of the national security council. When Mr Arafat was president, they ran respectively the Gaza and West Bank branches of Preventive Security (PS), one of the biggest forces. They would retain more influence if the unification of the security services were slowed or halted. Keen observers noted that the PS stayed away during the clashes in July between Mr Yusuf's forces and militants from Hamas, the main Islamist party. Inevitably, rumours also abound about why the PS in particular did not come to Musa Arafat's aid, as it is headquartered near his house.

However, if Mr Yusuf is made the scapegoat, it could be a big setback for the Palestinians. Having handed over Gaza, Israel's prime minister, Ariel Sharon—lionised by world leaders at the UN summit in New York this week—now has more sympathy than ever for his insistence that the Palestinian Authority must disarm militants before peace talks can resume. If Mr Yusuf, for all his limitations, goes, there is no obvious reformist to replace him. And if reform, however piecemeal, stops altogether, the security services will not take long to revert to their old feudal ways.

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Germany's election

The battle of the chancellorship

Sep 15th 2005 | BERLIN
From The Economist print edition

AP

It has been a mostly uninspiring campaign—and the result remains uncertain

Get article background

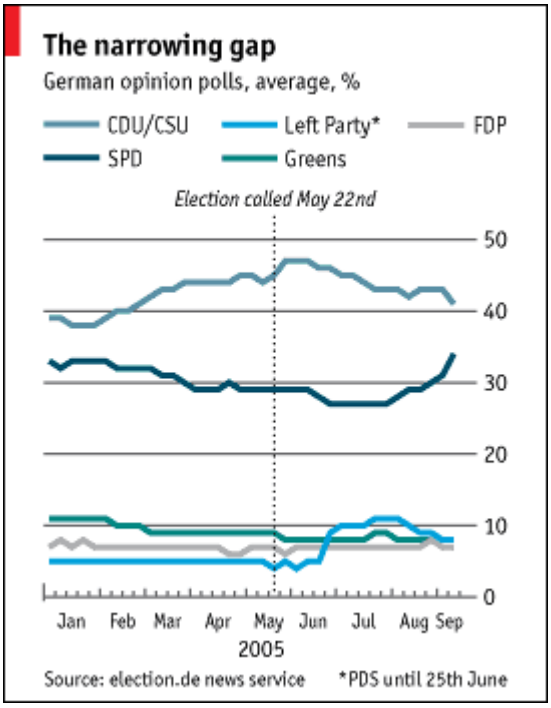
IT IS hard to exaggerate how much is at stake in the German election on September 18th. Will Germany spend the next four years tackling further reforms, embracing change and globalisation not as threats but as opportunities? Or will it continue to muddle through, running the risk that reforms peter out, and even of a lurch towards economic nationalism?

Which path it takes will depend largely on whether Angela Merkel, leader of the opposition Christian Democrats (CDU), which is all-but certain to be the largest party, wins a big enough majority over Chancellor Gerhard Schröder's Social Democrats (SPD) to form a government with her Christian Social Union (CSU) sister party and the Free Democrats (FDP). If she does, and can then show that “reform in a big rich country” is possible, argues Adam Posen of the Washington, DC-based Institute for International Economics (IIE), who is writing a book on the subject, Germany could become a model for other big European Union countries, such as France and Italy. Conversely, if Ms Merkel loses, or is forced into a do-little “grand coalition” with the SPD, the German experience could become an excuse for much of the rest of Europe to do nothing too.

Given such stakes, the election campaign has been parochial—and increasingly content-free. Often, the details of electoral programmes have seemed to matter less than pop music. Mr Schröder's stump speeches are preceded by Die Prinzen, a popular east German pop band, one

reason why he has drawn crowds of thousands. Not to be outdone, the CDU staged a coronation mass for Ms Merkel, with an ersatz Queen band warming up the crowd. Her speeches were followed by the Rolling Stones song, “Angie”. Only Joschka Fischer, Germany's Green foreign minister, who is crisscrossing the country by bus, has dispensed with a warm-up act—he is something of a political rock star himself.

Only in the past two weeks has the campaign itself warmed up, mainly because the opinion polls have narrowed sharply. When Mr Schröder called the election on May 22nd, after the SPD's disastrous loss in the state election in North Rhine-Westphalia, the polls pointed to a big win for the CDU/CSU and the FDP. Now they are no longer sure of even a narrow majority (this week most polls put their combined score at around 48%)—which is why pundits think the CDU and the SPD might be forced into a grand coalition (see chart).



What went wrong? Ms Merkel is not an inspiring campaigner. And it may not have been a good idea to recruit Paul Kirchhof, a former judge who favours a flat tax, as potential finance minister, because it gave Mr Schröder an easy target. Mr Schröder has used two televised debates to launch withering attacks on the “professor from Heidelberg” and his “radically unsocial” reform. Such language resonates with Germans who love consensus and dread too much change. In response, the CDU has now reactivated Friedrich Merz, its former leading economic thinker, who is popular with voters if not with Ms Merkel.

Scenting a chance to survive, Mr Schröder has also shown, yet again, that he is a magician on the campaign trail. In interviews with journalists, he has planted doubts about the widespread belief that he is a goner. “There is a majority—for me”, he has said, adding that he wants the SPD to reach 38%. Such a result would not be enough for him to form another coalition with the Greens, but it could lead to a grand coalition—conceivably with Mr Schröder himself as chancellor.

German voters seem unable to make up their minds what they want. Judging by the polls, what they would like is a CDU government, but with Mr Schröder, not Ms Merkel, as chancellor. Many think the SPD and Greens have done a bad job through seven years of slow growth and high unemployment, but they are not sure the opposition would do better. Germans are just “resigned”

to a change in government, says Renate Köcher, co-head of the Allensbach Institute, a polling firm.

What Schröder leaves behind

Such a contradictory mood fits Mr Schröder's legacy. It is too early to assess his place in history. But today Mr Schröder is best thought of as a man who took too long to grasp the need for economic reform. And even though, once he had done so, he stood firm behind the limited reforms he proposed, he also knew that it was time to go when electoral setbacks had driven his agenda into the sands.

For those who have followed Mr Schröder's career closely, this turn of events is hardly a surprise. It reflects his approach to politics, argues Franz Walter, a political scientist at Göttingen University. Most SPD leaders, he says, have been predictable. But Mr Schröder “trusted his instincts more than any principle. He was a master at taking people by surprise.” Mr Schröder did not work his way up the party machine, but imposed himself from outside, using his popularity as a lever. He prepared neither the party nor the public for his reform programme, called Agenda 2010, and he presented it in March 2003 as a mere laundry list. Nor did he consult widely before calling an early election.

This method has cost the SPD dear. The party has lost almost every state election since Agenda 2010 was unveiled. The chancellor's stop-go habit meant that reforms were not only poorly sold, but haphazardly implemented and badly timed—taking effect as recession hit. In hindsight, it would have been better to start Agenda 2010 early in Mr Schröder's first term, though he was at first stuck with Oskar Lafontaine, now co-leader of the Left Party, as finance minister and SPD chairman.

It is always hard to push reform through Germany's political system, which has grown ever more inflexible and deadlocked. A more typical SPD man than Mr Schröder could have got so mired in the bogs of German federalism (the Bundesrat, the upper house, gives the states a say on most important laws) as to achieve nothing at all. In Germany, it seems, any would-be reformer loses his majority in the Bundesrat—and Mr Schröder was no exception.

Yet the reforms Mr Schröder got through were a big step in the right direction. Even before Agenda 2010, he passed a pension reform whose effects are underestimated. He cut income- and corporate-tax rates. His health-care changes improved the finances of public health insurers. His much-criticised reform of unemployment benefits is yielding results in the form of lower take-up. In part thanks to these reforms, there are signs of economic revival. Unemployment, which climbed above 5m early this year, is falling. Exports are at record levels. Even domestic demand could soon rebound, presaging a return of economic growth.

Most important, Mr Schröder has created the conditions for further reform, albeit by falling on his own sword. Germans still seem likely to vote him out of office this weekend, but most now accept the case for change. And because the SPD has lost most state governments, there is no risk of the party regaining a majority in the Bundesrat soon, so it will be unable to obstruct a new government.

All this ought to make life easier for Ms Merkel, should she win. Just as Mr Schröder seemed right for the job in the late 1990s, she seems right now. "If Mr Schröder is a sprinter, Ms Merkel is a long-distance runner," says Wolfgang Nowak, head of the Alfred Herrhausen Society, a think-tank linked to Deutsche Bank. The east German politician, who has a degree in physics, is methodical, going through all options before making a decision. Insiders call her a "learning machine". She has certainly learnt much since Helmut Kohl plucked her out of obscurity in 1991—not least from Mr Schröder's experience. As early as November 2003, she was preparing her party for change, persuading it to commit itself to an overhaul of the tax and health-care systems. Last July, she published one of the more honest election programmes in post-war Germany: not a list of expensive promises, it includes unpopular measures such as a two-point rise in value-added tax (VAT).

Not radical enough

Given this rare opportunity and her political assets, Ms Merkel's reform plans may not be sufficiently bold. A CDU-led government would try first to bring in more labour-market reforms. One would strengthen the rights of firms and staff to negotiate company-level wage deals. Another would chip away at laws protecting workers against dismissal, by, for instance, confining some protections to people in companies with more than 20 employees. A third would cut unemployment-insurance contributions from 6.5% of gross salaries to 4.5%, paid for by the VAT increase.

Later, probably in early 2007, Ms Merkel's agenda gets more ambitious. One big reform would be to make the income-tax system simpler and more competitive internationally. Most loopholes and subsidies would go, and rates would be cut—the top rate going from 42% to 39%. Next come plans for radical change in health-care financing. Instead of basing contributions on salaries, Ms Merkel wants a flat-rate health premium for all Germans, ensuring that health-care costs no longer act as a tax on employment.

Yet there are big items missing from this list. Ms Merkel has no specific plans to deal with Germany's mushrooming fiscal deficit. By the CDU's own estimate, next year's federal deficit will be over €60 billion ($75 billion), pushing Germany's overall deficit close to 4% of GDP. It is an open question how some of her reforms will be paid for. Even the VAT increase may not actually happen, because of rising fuel prices and resistance from the FDP.

Both the CDU and the FDP are also timid on deregulation. They are long on plans to cut red tape and make labour markets more flexible, but short on tackling the network of subsidies and protection that impede competition, says the IIE's Mr Posen. Gutting this underbelly of corporate Germany would hurt part of the centre-right's constituency. Then there is the reform of Germany's federal system to make it easier to respond to change. A CDU-led coalition might push through a constitutional amendment to disentangle the powers of federal and state governments. But a politically tricky reform of Germany's “financial constitution”—a cobweb of tax-revenue equalisation and joint public spending—is not on the agenda.

Ms Merkel has an excuse: she must be elected before she can do anything, and being too candid would diminish her chances. She can be surprisingly willing to take political risks if the time is right. In 1999 she broke ranks to become the first CDU leader openly to attack Helmut Kohl, a move that helped her to the leadership. But there is a risk that she may not implement even the reforms she has proposed. “With a centre-right coalition, you just don't know exactly what you will get”, comments Klaus Günter Deutsch, an economist at Deutsche Bank's research arm.

One impediment is something Ms Merkel cannot do much about: the economy. Another rise in oil prices, or a plunge in the dollar, could kill Germany's fledgling recovery and make it even harder to bring in and pay for ambitious reforms. The trade unions could also cause trouble. Although they disliked Mr Schröder's Agenda 2010, they did not try hard to block it. Perhaps only an SPD chancellor could have begun reform in Germany. With a CDU one, the unions may put up a real fight, with strikes and street protests.

A bigger risk for Ms Merkel may come from her own party. Most conservative heavyweights are state premiers who will defend their regional interests, particularly over money. They agreed to the VAT increase only because they will get half the proceeds. What is more, their enthusiasm for reform is limited. The CSU leader in Bavaria, Edmund Stoiber, is not keen on the flat-rate health premium. And if Ms Merkel is successful and sticks around, she may prevent some state premiers from ever having a shot at the chancellorship.

Ms Merkel is vulnerable to friendly fire because she—like Mr Schröder—lacks a real power basis within her party. She became leader unexpectedly in the wake of a party-financing scandal. Being less of a media charmer than Mr Schröder, she cannot use popular support as a counterweight. Her best bet may be to disarm rivals by giving them jobs in her cabinet and to use the FDP, which is more pro-reform, to counteract the forces of reaction.

Some still argue that a grand coalition may be a better route to reform. Many German voters like the idea of all parties coming together to form a consensus for tackling big issues. Were a grand coalition to include centrist SPD politicians such as Peer Steinbrück, a former premier of North Rhine-Westphalia, many would approve and hope that it might tackle Germany's fiscal quagmire, reform corporate tax and modernise federalism.

Yet it is more likely that a grand coalition run by a weakened Ms Merkel with a disgruntled SPD would end in paralysis—rather as has the current government, with the opposition in control of the upper house. There is little common ground between the parties. Each would be manoeuvring to blame the other for unpopular measures. A grand coalition could well split the SPD. And it would boost more extreme parties, notably the Left Party, which aspires to join a new left-wing coalition at the election after this one (the SPD insists it will not work with the Left Party this time).

German voters, unwilling to choose decisively one side over the other, may end up backing neither. In which case the country's stuttering process of reform and recovery could be in jeopardy. The stakes are indeed high this weekend.

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Economist.com WORLD EUROPE

Norway's election

Back to the left

Sep 15th 2005
From The Economist print edition

An oil-rich country tilts leftwards

Reuters

Stoltenberg bounces back

FOUR years ago Norway's Labour Party suffered its worst election defeat since 1924. Yet the party, now led by Jens Stoltenberg, won the election on September 12th. Mr Stoltenberg will now form the country's first majority government in two decades. He and his two allied parties romped home with 87 of the parliament's 169 seats among them, giving him a comfortable majority over the outgoing centre-right coalition led by Kjell Magne Bondevik.

Mr Stoltenberg served a brief stint as prime minister five years ago. Yet the real question is not why he won, but why Mr Bondevik lost. Unemployment is low, wages are high, education is free and the United Nations has once again ranked Norway as the best country in which to live. This enviable lifestyle is largely bankrolled by North Sea oil, the proceeds of which are stashed away in a Petroleum Fund now worth NKr1.2 trillion ($190 billion), and rising fast. Non-oil business is also booming: a survey of some 114,000 non-oil companies shows an average 43.9% increase in profits.

Yet many of Norway's 3.4m-odd voters do not share the view that they live in nirvana. With all that oil wealth, they cannot understand why the welfare system has so many defects. There is a shortage of kindergartens, hospitals are understaffed, taxes are high, petrol costs as much as in non-oil countries and pensioners have problems making ends meet. A groundswell of such discontent swung the election Mr Stoltenberg's way. He made a string of lavish promises to cut child-care costs, guarantee kindergarten places, extend maternity and paternity leave and even hand out free fruit to schoolchildren.

It is easy to exaggerate Norway's leftward swing, however. Indeed, overall the right actually won more votes but fewer seats. A crucial factor was that Carl Hagen, the populist leader of the far right Progress Party, had his best ever election, taking his party's representation from 26 seats to 38 to become the second-biggest in parliament. Mr Hagen held the balance of power in the outgoing parliament and used it to full effect to squeeze concessions from the government. He has now lost that position.

Even so, over the next few weeks, Mr Stoltenberg may find it hard to form a coherent government. Besides divvying up cabinet posts, his three-party coalition must find common ground on some key policies. Labour is pro-European Union, its two partners are Europhobes. Labour favours gas-fired power generation, the others fret about pollution. Despite his election promises, Mr Stoltenberg is cautious about raiding the Petroleum Fund. Mr Bondevik, retired from the limelight to his rocking chair, will surely be praying for an unholy falling-out among the three

new friends that might yet let the centre-right back in.

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Ukraine's political crisis

And then they woke up

Sep 15th 2005 | KIEV
From The Economist print edition

The dream of a democratic, non-corrupt Ukraine may die

Get article background

AP

No longer orange for Timoshenko

LIKE many separating lovers, they were at first civil—but they soon gave up. President Viktor Yushchenko now accuses Yulia Timoshenko, the other leading light of the orange revolution and Ukraine's prime minister until he sacked her last week, of abusing her position and misusing government funds. A sign of his weakness, says Mrs Timoshenko, piously: “I am ashamed for him.”

Ukraine's government imploded after the president's chief of staff resigned, accusing (among others) Petro Poroshenko, the head of the national security council, of corruption. The charges involve familiar sorts of graft: pressuring judges, auctioning access to the president and so on. Mr Poroshenko, a wealthy businessman—and, according to Mrs Timoshenko, the man who ruined her relationship with the president—insisted that his office had not enriched him by a single kopeck, but he still quit. Mr Yushchenko says he tried to broker a trade-off of other resignations between warring factions; in the end, he fired them all. Mrs Timoshenko says she was punished for obstructing the looting of the country, and to distract attention from a corruption scandal. This is “a very stupid theory”, says Mr Poroshenko.

Beneath the slung mud lies a complex confection of greed and rivalry. Mr Yushchenko says the last straw was a recent, near-violent stand-off at a big factory, part-owned by Viktor Pinchuk, the son-in-law of Ukraine's previous president. Mrs Timoshenko wanted the state to take back Mr Pinchuk's stake: for her own self-interested reasons, says the president; because its privatisation had been illegal, says Mrs Timoshenko; out of vengefulness against his family, says Mr Pinchuk. Mrs Timoshenko says, not incredibly, that Mr Poroshenko was brokering a deal (he denies it), whereby Mr Pinchuk could sell his stake to Russian businessmen, if he divested himself of some television stations.

The political event that has divided the government, which Mr Poroshenko says is the root cause of the debacle, is the parliamentary election next March. Under a constitutional reform agreed last year, some powers are to be transferred from the presidency to a prime minister nominated by parliament. The Yushchenko and Timoshenko factions were supposed to stand together; Mrs Timoshenko, who never met a rabble she didn't try to rouse, will now be a formidable opposition leader. In a turnaround startling even by the standards of Ukrainian politics, Mr Yushchenko is flirting with supporters of his opponent in last year's presidential vote, Viktor Yanukovich. Mrs Timoshenko has taken to sporting a blue ribbon alongside her orange one. Previously opposed to the constitutional reform, she now says it may be a lesser evil than an over-mighty presidency.

Who will benefit from this farce? Mrs Timoshenko says she never wanted to break from the president, and that an 11th-hour meeting with him was interrupted by Mr Poroshenko, “covered in tears and snot”. Her integrity has been questioned (again). But she leaves government before her demagogic inflationary policies inflict more pain. She is popular, and she now has victim status: like some spouses, it may have been more congenial for her to be thrown out by Mr Yushchenko than to have to walk out.

The best that can be said for him is that, like other revolutionary coalitions, his was destined to fall apart. Perhaps, indeed, the sackings mark the end of revolution and the beginning of government—and maybe a new determination to take on corruption. Unfortunately, a forlorn Mr Yushchenko has been less than even-handed. He blames Mrs Timoshenko and her allies exclusively. He has set up a commission to look into the allegations against Mr Poroshenko, but says he has seen no facts to support them (though he offered none in support of his own charges against Mrs Timoshenko). Naive loyalty to his allies is the kindest interpretation of this.

The big loser is Ukraine. Subject to confirmation by parliament, the new prime minister will be Yuri Yekhanurov, a technocrat who has signalled a less aggressive attitude to past privatisations and a more conciliatory one to Russia—sensible, given that a rise in Russian gas prices could be disastrous. But it will be hard for him to achieve much before March. Meanwhile, disillusioned Ukrainians fear that the new government will be as preoccupied with nest-feathering and back-stabbing as the old one. It may be too soon to conclude that the revolution was simply the victory of one corrupt elite over another. But, as Mr Yushchenko said last week, “the government obtained many new faces, yet the paradox is that the face of the government itself did not change.”

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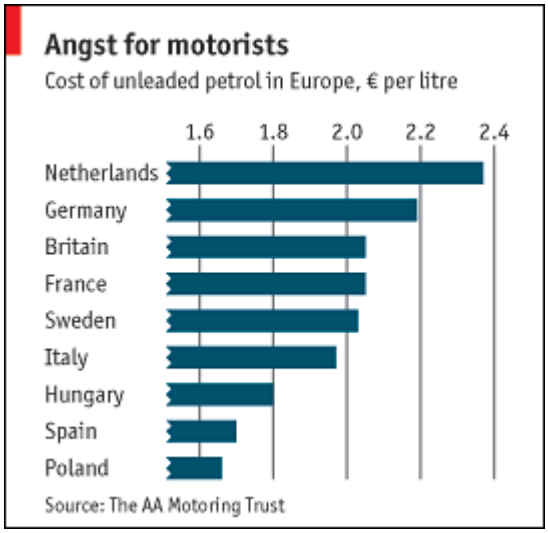
Petrol prices

Pumped up

Sep 15th 2005
From The Economist print edition

European governments fail to hold the line on petrol prices



EUROPEAN Union finance ministers remember grimly the concessions they made in 2000, when truck drivers last staged protests against a rise in petrol prices. As prices shoot up again, they vowed this time to maintain a united front and refuse to cut fuel taxes. Poland showed itself ready to yield, but last week Britain's Gordon Brown, president of the EU finance ministers' club, persuaded his colleagues to concede no more. (Mr Brown appears to have faced down planned fuel protests in Britain, though panic buying was widespread.)

Yet the show of unity proved short-lived. To the surprise of few, the French were among the first to break ranks, announcing special rebates for road hauliers and farmers. Several other governments facing threatened protests also acted: Belgium, the Netherlands and Hungary all introduced subsidies or tax cuts. Even the British have postponed a planned tax increase.

Other EU countries have adopted a new form of blackmail. Austria threatened a windfall tax on oil-company profits unless petrol prices were cut. The companies claim that the subsequent price fall was not connected, but that is not how it looked to many. France's Jacques Chirac was quick to look for political capital by attempting to wring price concessions out of Big Oil.

Petrol prices may fall back again as the market settles, the effects of Hurricane Katrina fade and oil producers (and refineries) step up production. The naked capitulation to fuel protesters of 2000 may be avoided. But the short-term remedies that are being tried will not help and may prove counterproductive, because they partly insulate fuel users from a strong market signal. Petrol taxes are there to capture and charge motorists and others for the externalities they create, such as pollution and congestion. Yet the real costs of motoring have fallen in the past two decades. To cut fuel taxes when oil prices rise is bad economics as well as dubious politics.

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Italian politics

Electoral games

Sep 15th 2005 | ROME
From The Economist print edition

The centre-right government proposes a sudden change of the rules

Get article background

OPPOSITION politicians have long wondered how Silvio Berlusconi plans to win the next election, which must be held by May 2006. The economy is stagnating; Mr Berlusconi's right-wing coalition is in disarray and trailing in the polls. On the evening of September 13th, they feared they had their answer, when government parliamentarians suddenly tabled a legislative amendment that would change the rules for the election.

Romano Prodi, who hopes to replace Mr Berlusconi as prime minister, said the amendment was "tantamount to theft" and threatened to paralyse the legislature unless it was dropped. The new proposal would give the electoral system its biggest shake-up since 1993, when Italy decided to turn its back on the extreme form of proportional representation that was one cause of its chronic political instability.

Since then, Italy has had a hybrid system, in which three-quarters of the seats in both chambers are won on a "first-past-the-post" basis, with the remainder decided by proportional representation. The PR vote is subject to a 4% threshold meant to keep tiny parties out of parliament (they tend to get in all the same, because, in the horse-trading to form broad alliances of right and left, bigger parties win over smaller ones by giving them safe seats decided by majority vote).

The latest proposal would reinstate full proportional representation, but with a series of extra provisions ostensibly intended to produce stable government. This alone should favour Mr Berlusconi and his allies, who have always done better in the proportional vote. Psephologists reckon it could give them a two-point gain.

Under the new system, there would still be thresholds for securing representation in parliament—4% in the lower house and 3% in the upper. But parties that failed to reach them would not merely be excluded from parliament. They would also be left out of the calculation to decide which side was the winner. This is crucial, because the winning side would then have its tally of seats increased to ensure that it had an outright majority. Thus, an alliance made up of a couple of big parties and several little ones could win more votes and yet end up with fewer seats. By an amazing coincidence, the opposition centre-left Union is just such an alliance.

The potentially perverse effects of the proposed reform are not the only reason why many Italians take a dim view of it. They have repeatedly shown that they want a stable democracy of alternating governments. That was the message of a referendum in 1993, when 83% voted for change. The system that has developed since has delivered something close to what the voters wanted. It has not reduced the number of parties in parliament, but it has herded them into two alliances, one of which has been in office for four years.

The proposed new electoral law risks turning the clock back to the days when Italy was repeatedly paralysed by coalition negotiations and run for most of the time by an all-encompassing Christian Democratic party that was incapable of decisive action. Mr Berlusconi may hope to help his own side; but when it comes to Italy's future, he is playing with fire.

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Spain's building boom

Costa del concrete

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The downside of too much construction

SOMETIMES Spain seems to be a huge, cacophonous building site. Construction is even blamed for the drought, because it drains water to sustain a concrete belt along the coast. The practice of illegally setting fire to protected land to get it re-zoned for development has also triggered forest fires.

Spain is the biggest consumer of cement in the European Union, sloshing down almost 50m tonnes of the stuff every year. In 2004 some 180,000 holiday homes were built along the coast. A million more are planned on the Costa Blanca alone over the next decade. *El País*, a daily newspaper, has lamented that Spain's "destructive" construction has already irrevocably scarred much of the country. Satellite photographs show that, in the past ten years, the area of developed land has expanded by 25%. As much as one-third of Spain's Mediterranean coast is under concrete.

Spain has a higher proportion of homeowners than any other large rich country. Its holiday-home market has made it the Florida of Europe, with foreigners, mainly Britons and Germans, buying half of all second homes on the coast. The construction boom has enriched those who speculated on land prices on the edge of cities like Madrid. It has also led to endemic corruption. Companies negotiate with municipal or regional governments to reclassify land for residential building. In some places, developers have even managed, dubiously, to wrest title from foreign owners of holiday homes to get land re-zoned for more intensive building.

The boom has created a construction industry worth as much as 16% of Spain's economy. But will the glory days last? Frédéric Mangeant, a partner at Knight Frank, an estate agent, in Madrid, says "it is dangerous for an economy to be built almost solely on a construction boom." He is among many praying for a soft landing for house prices. His firm hopes that demand will be sustained by a growing immigrant population, as well as by first-time buyers.

He also notes that Spain's construction giants are diversifying abroad. One of the biggest, Grupo Ferrovial, has bought Swissport International, an airport ground-handling company, only weeks after a $220m deal to buy a Texas-based construction company. Earlier this year another giant, Metrovacesa, took a 30% stake in France's Gecina, one of the biggest such deals in Europe.

The diversification reflects another fact of Spanish life: that the annual €7 billion ($8 billion) of EU cash given to Spain is drying up. Interest-rate rises are also a worry. It looks as if the construction cycle is peaking, and Spain's housing boom may be ending. Its legacy will be an enviable network of motorways, a big construction lobby, some rich politicians—and an awful lot of concrete.

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Economist.com WORLD EUROPE

Charlemagne

When to talk Turkey

Sep 15th 2005
From The Economist print edition

Wrangling over Turkey's entry talks reflects broader doubts about the European Union's direction

Get article background

ENLARGEMENT has been one of the European Union's great successes, bringing stability and democracy to parts of the continent which have had too little of either. But the policy is about to be put to its biggest test. On October 3rd, the EU is due to open negotiations with the biggest and most important country to have asked for membership so far. That country is Turkey.

Turkey first applied to join what was then the EEC in 1959. The two sides signed an association agreement in 1963 (implicitly accepting that Turkey could be a candidate); a customs union in 1995; and the EU officially accepted Turkey as a candidate for entry in 1999. Turkey has, in short, been asking to join Europe for so long that its application is starting to look old and moth-eaten—so much so that some diplomats and politicians seem to have forgotten the strategic reasons for entertaining it.

The long period of fobbing off Turkey is now over. Last December, EU heads of government promised to start negotiations on October 3rd if Turkey met just two more conditions (which it has done). To get this far, Turkey has taken such dramatic steps as abolishing the death penalty, accepting Kurdish as a language in schools, scrapping state security courts, revising the penal code and tightening civilian control over the army.

This is a last chance, for both sides. Turkish patience with EU obstructiveness is running out, as is European willingness to accept new members. Last December, the French, German and Dutch leaders, among others, agreed to start talks. They might not do so now—France and the Netherlands after their lost referendums on the EU constitution, Germany because of its impending election. Angela Merkel, the most likely winner, has said she will respect European processes that are under way when she takes office, which would include the Turkish talks if they start on October 3rd. But if the date slips, Ms Merkel might want to reconsider: she is strongly against Turkey's membership.

All this makes it worrying that, as curtain-up nears, the EU is suffering from a bad case of stage fright. Two issues threaten to abort the talks: Turkey's refusal to recognise Cyprus, and the desire of some countries to offer Turkey something less than full membership. It is obvious to all (including the Turks) that Turkey must recognise Cyprus eventually; indeed, that is one reason why the Cypriots and Greeks have supported the entry talks. The question is whether it must do so before they even start. This week, the French government accepted a diplomatic declaration that would let the talks begin without recognition. Cyprus still objects, but nobody pays much heed to its views.

Yet even if this first problem responds to treatment, it is not certain the second will. This is the threat that some members might insist on putting a “privileged partnership” into the framework

document for negotiations, as a back-up in case membership talks fail. The Turks see this as an insult. Wrangling is likely to continue until the last minute. The best that can be said is that the chances of the talks starting on time are greater than they were two weeks ago and probably better than 50:50.

Answering the eastern question

All of these last-minute wobbles reflect an underlying ambiguity about Turkey. Clearly, it is a special case. By 2015 it will be larger than any other EU state by population, which has unsettling implications for its voting weight and representation in the European Parliament. The EU spends most of its money on farming and aid to poor regions—and Turkey is amply provided with both. In every previous enlargement, there were doubts about the readiness of the applicants to assume the obligations of membership. This time the biggest doubts may be about the ability of the club to absorb the would-be member.

Yet rejecting Turkey's bid for membership would do little to solve the difficulties its application raises. The budget needs to be reformed whether Turkey is in or out. Europe's economies must create more jobs whether or not Turkish workers get free movement of labour (which they probably won't). Popular dissatisfaction with the EU exists regardless of Turkish membership. A majority of Europeans say they are undecided about Turkey, rather than actively hostile.

Were Turkish membership to be rejected, the EU's existential problems would not disappear. Indeed, they might get worse. For a start, rejection would cause a crisis in Turkey. The government is an uneasy coalition of religious nationalists and westernising moderates. It is under strain from a renewed upsurge of Kurdish terrorist violence. A simultaneous failure of the government's EU policy might break apart the coalition, and even lead some Turks to look for an alternative such as a link with Russia or other countries to Turkey's east.

The problems for Europe would be less dramatic but no less profound. After September 11th, taking Turkey into the club is no longer just a question of helping a big and strategically important country to modernise. It is a test of whether the EU, and the West as a whole, has any role in encouraging moderate and democratic Islam. To precipitate a crisis in the nearest big Muslim country, and one that is both democratic and secular, would be a colossal blunder. Turkey may not be a model for democracy throughout the Middle East: Arabs certainly do not see it as such. But rejecting Turkey would still be taken by many Arab countries as rank hypocrisy or even racism by the West.

A few Europeans might justify the wreckage as a necessary cost of defending EU integration. But since the problems of popular support, the budget and so on exist regardless of Turkey, its rejection is unlikely to produce the “deeper” Europe they crave. The French and Dutch referendums have kyboshed further integration for quite a while, and perhaps for ever. Rejecting Turkish membership would probably halt other enlargements too. Europe would end up neither wider nor deeper; merely static, and with its south-eastern border in turmoil.

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Electricity

The power to change

Sep 15th 2005
From The Economist print edition

Large bits of Britain's power-generation capacity will disappear over the next decade. That will test the government's commitment to markets

UNLIKE most other industrialised nations, Britain has long had the good fortune to be self-sufficient in energy. Partly because of that it has, for the past decade, pursued an unusually free-market approach towards electricity generation. Over the next ten years, however, the government's commitment to that policy will be tested. Oil and gas production from the North Sea is running down, meaning that Britain will rely increasingly on imports. That will coincide with big changes in the electricity market, as many of Britain's coal and nuclear power plants (which between them produce just over half of the nation's electricity) begin to go off-line.

For nuclear power, the problem is age. Atom-splitting provides a fifth of Britain's electricity, but most of the reactors are decades old and near the end of their operational lives. Ten years from now, nuclear's share of generation is expected to fall to 11%; by 2020 it will be just 7%.

For coal, greenery is responsible. Tough new environmental rules, especially a European directive requiring coal stations to fit expensive chimney-scrubbing equipment, will make it harder for coal to pay its way. Plants that don't comply with the new rules will have to shut by 2012. Malcolm Grimston of the Royal Institute of International Affairs (RIIA) thinks that half Britain's coal capacity is threatened.

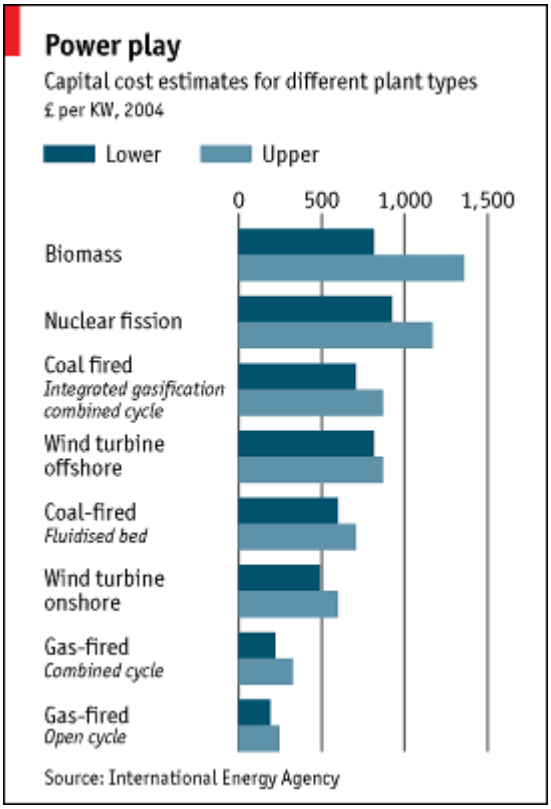
The government has not been entirely hands-off during these years of plenty. Its flagship policy has been subsidies for renewable energy—mostly wind power—justified on environmental grounds. Supporters point out that renewables can make a contribution to energy security as well as reducing carbon emissions. Ministers want renewables to generate a tenth of Britain's electricity requirements by 2010.

But, says Gareth Davies, a researcher at Oxera, a consultancy, that seems a vain hope. And although renewables don't require fuel and are, in that sense, the most secure of all energy supplies, they are intermittent—especially windmills, which are useless on a still day. This makes them unsuitable to replace the reliable “base-load” provided by coal and nuclear plants.

Complaints about the cost are growing, too. The National Audit Office, an independent watchdog, predicts that subsidies to renewables will cost £1 billion ($1.8 billion) a year by 2010. A recent report from the Public Accounts Committee reckons that another £1.5 billion will be needed if the national grid is to reach out-of-the-way wind farms, and complains that none of the subsidies are scrutinised by Parliament. And while the public likes the idea of renewables, it is less keen on the reality, with fierce planning battles springing up over several proposed wind farms.

An alternative is to replace old nuclear plants with new ones. The nuclear lobby is busily pointing out that nuclear power is well-understood, carbon-free, and would contribute to security of supply (uranium can be bought from stable, friendly countries such as Australia and Canada). New reactor designs, says the industry, are cheaper, cleaner, and easier to build. The European

Emissions Trading Scheme, which puts a price on carbon, is raising the cost of nuclear's fossil-based competitors.



But historically, atomic energy has had a vast appetite for public money, and its economics are still tricky. Although they are cheap to run, nuclear plants are expensive to build (see chart). Investors are wary of an industry with big, front-loaded capital costs that are repaid over several decades. In Finland, currently building one of the new generation reactors, long-term contracts between power users and suppliers help mitigate these problems. Without some form of government intervention (regardless of the free-market commitment) new nuclear power looks like a hard sell. Before they open their chequebooks, many financiers will insist that the government caps their exposure to risk—particularly over the cost of waste disposal and insurance. Despite that, the government has hinted heavily that new nuclear plants will be approved, although it would take several years to win the argument—let alone build any.

In the meantime, new capacity will almost certainly come from natural gas, which has been increasing its market share ever since the Conservatives liberalised the electricity market in the 1990s. Gas is both economically and environmentally appealing. It emits less carbon than other forms of fossil-fuel generation. Low capital costs and the short times needed to build new stations are attractive in a market in which storage is difficult and prices and demand can fluctuate. Gas already produces around 40% of all electricity, and Mr Davies expects that to climb to 60% by 2020.

But such dominance would pose tricky questions for ministers. The government's energy policy commits it to cutting carbon emissions and maintaining secure supplies—as well as keeping markets free. If the market chooses to replace carbon-free uranium with carbon-producing gas, carbon targets will be elusive. And relying on one fuel type raises questions of security.

The government thinks these aims are compatible. “Diversity of supply is the key to security,” it

says, pointing out that there are plans for more gas storage, as well as diverse supplies from as far afield as North Africa, Russia and the Middle East.

But while that will help to hedge against political risks, it will be less useful in dealing with price-related risk. Energy is a political subject, and Mr Davies points out that because of the volatility of power prices, long periods of expensive electricity are needed to spark big investments. In the meantime, the system could come under strain. “A particularly cold winter could well catch us out,” says the RIIA's Mr Grimston. “If there were power outages, there's a risk that the government will panic.” That would really test ministers' commitment to the market.

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Pub design

Return of the gin palace

Sep 15th 2005
From The Economist print edition

Why a partial ban on smoking could revive 19th-century drinking practices

A BAN on smoking in pubs came closer last week, when the government's consultation on a proposed new law ended. For libertarians this unwelcome news is tempered by the possibility that the law could bring about an unexpected architectural revival.

The proposed law distinguishes between places that serve food—to be smoke-free—and those that do not. One way to get around a ban would therefore be to stop dishing up pub grub. But another, according to Richard Seedhouse of the Victorian Society, which worries about the preservation of 19th-century buildings, might be to restore the original interiors of pubs, many of which are Victorian. A typical Victorian pub was divided up into many smaller spaces. If those were restored, smokers and non-smokers could avoid each other, without interrupting the flow of lasagne and chips from pub kitchens.

Victorian pubs typically had at least two separate areas: a public bar for the poor and for labourers and a better room for shopkeepers and skilled workers. The two were split by frosted glass and mahogany. Some also had a smoking room. The rooms had separate entrances from the street (to avoid any unsavoury mingling) and charged different prices for the same beer.

This layout contributed to the gaudy magnificence of Victorian pub design. The *Architectural Magazine* described the ideal style in 1834: “He who most lavishly bestows plate glass and gilding, together with a happy corruption or combination of all three of the Grecian orders into one, is the most likely to insure success to himself in these gin-drinking times.” But in the 1960s and 1970s, all bar around 200 of these interiors were cleared out to make more room for drinkers and to please the police, who found it easier to check what was going on in one large room than to inspect lots of small ones.

Technology has solved that problem. Sam Smith's, a brewery that owns lots of old pubs, has been busily restoring partitions in its Victorian pubs, to the delight of the Victorian Society. Each area of the pub now comes with its own CCTV camera in the corner. A company architect says this makes it much easier to keep watch on even the dark corners where those rowdy Victorians liked to drink. And to spy on smokers too.

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Bosses' pay

Sink, or swim in champagne

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Bosses' pay is still rising—but it increasingly reflects performance

Get article background

ALONGSIDE moaning about the weather, public transport and the national football team, “fat cat” bosses and their undeserved pay packages have become a staple of British conversation. But a new report from Deloitte & Touche, an accounting firm, suggests the cynicism is out of date. Pay in Britain is becoming more linked to performance: when managers earn a lot, they are more likely to deserve it; when they fail, they suffer.

Although bonuses are getting bigger, especially at the top (in the 30 largest companies, maximum bonuses are now 150% of salary, compared with 125% in 2004), bosses are having to work harder for them. Traditional share-option plans are out of fashion: only 48% of FTSE-250 firms offer them today, down from 76% two years ago. They are being replaced by new-fangled performance share schemes, in which shares are given directly to bosses in return for doing better than their competitors.

Deferred bonus payments have also become more common. Typically, these require parts of an executive's annual bonus to be paid in shares, which must then be held for a period of several years—a way to reward long-term performance, and prevent directors cashing in on short-term gains. And the number of companies offering long notice periods has fallen sharply, helping to stop huge severance packages.

Carol Arrowsmith, the head of Deloitte's executive-pay team, says the change is due to shareholder pressure and new rules. “Shareholder power was transformed in 2002 when the government gave them an advisory vote,” she says. Shareholders' votes hold no formal power, but shaming overpaid bosses can have a powerful effect, as Jean-Paul Garnier, the head of GlaxoSmithKline, found in 2003, when shareholders voted down his pay package. Other rules forcing companies to account for share options in their profit-and-loss accounts also had an effect.

This may not end the whingeing, though. Bosses' basic salaries are still rising, although more slowly than they have been—executives got a 6.5% pay rise this year, down from 7.5% in 2003, but roughly two percentage points more than the national average. While tying pay to performance is a welcome development, publicly listed companies will have to keep an eye on their unlisted competitors. Their top brass can earn eye-watering salaries without worrying about hostile press comment or stringent disclosure requirements.

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Riots in Northern Ireland

Boiling over

Sep 15th 2005 | BELFAST
From The Economist print edition

The politics of victimhood catches up with Belfast

Get article background

IT WAS not a very big detour, but the 100-metre diversion last weekend of a Protestant march around a Catholic area threatens to push Northern Ireland's peace process a long way off course. The bricks and burnt-out vehicles that littered Belfast after three days' rioting by working-class loyalists conjured up the unrest of 20 years ago. Back then it was mostly Catholics fighting police and soldiers or Catholics fighting Protestants. This time it was Protestants fighting police and soldiers.

There was a weary inevitability about this week's recriminations. Orangemen condemned the decision to reroute their march; the police condemned the Orangemen; the rioters condemned the police; America's envoy lamented the lack of Protestant leadership; and the main unionist party, the Reverend Ian Paisley's Democratic Unionists, dismissed him as “damaged goods”. The rioting came as the IRA is—supposedly—close to decommissioning its arms, now being gathered from across Ireland into a few dumps. That, in turn, follows a Republican promise in July to stop all criminal activity, a step Tony Blair praised with almost indecent haste as being of “unparalleled magnitude”.

In a rudimentary sense, the riots were a reaction to all this, and not about a march at all. Unionists enraged by the idea that their Republican opponents are getting an easy ride from politicians in London and Dublin talked of grievances unaddressed by the authorities, “a cry of desperation”, said the Orange Order Grand Master. Chief Constable Sir Hugh Orde pointed out that petrol bombs, pipe bombs and homemade grenades had been prepared and stockpiled before the march. Police film, the chief constable reported, showed Orangemen standing beside masked men orchestrating the violence.

But that is not to say the violence formed much of a plan: even veteran Ireland watchers were alarmed at its arbitrariness. Soon after the rioting began, Orangemen started throwing missiles alongside masked and hooded men and paramilitaries began shooting at soldiers and police. The gunmen fired scores of bullets: a total of 50 shots hit two police vehicles. Near the point where police blocked the marchers' preferred route, a bandsman unzipped his trousers and made obscene gestures. As night fell, rioters in a crowd of about 700 used a stolen digger to flatten lampposts along a stretch of road in east Belfast. Traffic lights buckled, a bus-shelter was uprooted—though the rioters, who can recognise an essential amenity when they see one, largely spared the heavily shuttered pawnbroker advertising “pay day loans”.

The rioting flared in a string of Protestant towns, too. In the village of Ahoghill, heart of an area where outnumbered and isolated Catholic families were attacked over the summer, youths broke windows in the homes Catholics had fled. A bus full of mainly elderly people returning from a church service in Belfast was hijacked near the sedate seaside town of Bangor by armed men, who then robbed the passengers before setting it alight.

Most of the rioting took place in five of Belfast's ten most disadvantaged wards, measured by such things as employment, income and health. From that perspective, it was alarmingly self-defeating, wrecking shops and businesses and driving away would-be investors.

The digger that tore up east Belfast came from a nearby building site for offices, workshops and businesses, that was the brainchild of a partnership created by local community workers with business and government agencies. Like more than 70 projects in Protestant east Belfast supported by £14m of “Peace Fund” money, the partnership is designed to help take the place of the defunct shipyard that was once the district's pride. “We just have to pick ourselves up and start all over again,” one of the east Belfast partnership's founders said stoically.

Even if they were its victims, the poorer districts at first approved of the rioting. People told reporters that violence was the only way to get Mr Blair's attention: “It's all concessions to the IRA—nationalists get everything they want,” one said.

Poverty and the politics of victimhood are aggravated by a criminal feud between Ulster's loyalist paramilitaries. In a murky underworld, the Ulster Volunteer Force (UVF) has always been seen as more political than the larger Ulster Defence Association (UDA)—less steeped in “ordinary” criminality (a relative judgment, of course). In a depressing twist to today's violence, the UVF has been largely blamed for the rioting and for the four deaths in months of fighting with the splinter Loyalist Volunteer Force, a group that now appears entirely devoted to drug-dealing and gangsterism.

These groups, recruited from Ulster's working-class Protestants, are divided from unionist politicians by social class and political rivalry. Their efforts a few years ago to form political parties, following the lead of Sinn Fein, collapsed amid rows about drug dealing and racketeering. For them, riots are just about the only way to make a noise.

On Tuesday, one more ingredient was poured into the mix. The family of Robert McCartney, the Catholic killed by drunken IRA-men in a pub brawl last January, claimed that in east Belfast the IRA used the rioting as cover for a brutal attack on one of the dead man's friends. Although Republicans denied they had been involved, the accusation will only heighten unionists' belief that the IRA is not about to go out of business.

Only seven weeks ago, with the IRA's pledge to quit its career of terrorist murders and bombings once and for all, Northern Ireland seemed about to enter a new phase in its journey towards normality. Everyone knew this would take time: for the IRA to destroy its arms, for elections and for the unionists to come around to the idea that sharing government with Republicans was the least bad thing to do. After this week's violence, that future looks just a bit more uncertain.

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Economist.com WORLD EUROPE

Monitoring health care

Retail therapy

Sep 15th 2005
From The Economist print edition

Shopping around for health care

Get article background

IN 1995 18-month-old Joshua Loveday had open-heart surgery at the Bristol Royal Infirmary. He died on the operating table. The surgeon's high death rates had already started to worry colleagues and, on the evening before the operation, one of them tried to persuade him to cancel and refer the child for surgery elsewhere.

Joshua's death was the catalyst for an independent public inquiry into the high number of children dying after heart surgery at the infirmary. The inquiry heard evidence that, for at least ten years, death rates had been much higher than at comparable centres: around 35 more children under one had died than if performance had matched the norm.

His death also led ultimately to the creation in 2004 of the Healthcare Commission, an independent watchdog overseeing all health-care providers in England. It is now the commission's responsibility to investigate complaints about health-care standards, in particular, concerns about facilities with unusually high death rates. For example, in April 2005 an investigation by the commission led to outside experts being put in control of maternity services at Northwick Park Hospital in London, where ten women had died in three years—a rate more than five times higher than the national average.

Investigating such concerns is not, however, the commission's central task. This is to monitor all National Health Service Trusts and to produce yearly ratings indicating how each is performing. Such monitoring has the potential to save many lives, by enabling health-care providers to share best practice and improve their own performance. The commission estimates that as many as 25,000 of the 8.5m patients admitted to hospital each year die because of substandard care.

The masses of information that come out of this monitoring could be of interest to more than just health-care professionals. The government has set up a new system called Choose and Book, under which, by the end of this year, every patient who needs elective surgery should be able to choose between four or five different hospitals. But without high-quality information about the alternatives, such freedom will be meaningless—and most patients wouldn't know where to start.

This may be why Choose and Book has not captured the public's imagination. Research carried out earlier this year for *Which?*, a consumer watchdog, found that very few people wanted to be able to choose their hospital: they felt unqualified to make such choices, and said that they just wanted their local hospital to be good.

In their current format, the Healthcare Commission's ratings are not particularly helpful for patients looking to make informed choices. Although they are produced by aggregating all sorts of useful statistics (from the number of emergency readmissions in the 28 days after treatment for a fractured hip, to the number of suspected cancer patients who get an outpatient appointment

within two weeks of an urgent referral by their family doctor), pretty much all the information that could be used to help patients choose is lost when it is boiled down to a series of stars, three for good and none for bad.

The rigid classification into just four categories can also lead to farcical outcomes. In 2004 Addenbrookes Hospital in Cambridge was shocked when it was downgraded from three stars to two. Working through its returns to the commission, it found it had lost the precious star because one box had been left blank. The box could be ticked only if the hospital was represented on a local child-protection committee—but the local council had decided that it didn't need to be. Addenbrookes appealed, and successfully recovered its third star.

Although the star ratings are not particularly useful for patients, the indicators and high-quality data used to create the rankings might be. And now the Healthcare Commission is seeking to make this information more widely available and easier to grasp.

From next year, star ratings will be replaced by a hospital “health-check”, in which the data will be much less aggregated, and hence much more useful. Hospitals will score themselves and a group within the Healthcare Commission will screen the returns.

Statisticians have to design a system to help the checkers in the Healthcare Commission decide whom to inspect. It must be able to tell variation due simply to chance from unusual, perhaps substandard, performance, and to spot when seemingly poor results are due to larger-than-average numbers of hard cases. And the statistics all need to be presented in a clear, graphical layout. This is just the sort of information patients need, too.

The realisation that people knew something was wrong in Bristol, but did not tell them, has tormented the parents of children like Joshua Loveday. That is why patients will hope that, more than anything else, shopping around will spare them the misery of pointless suffering.

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Public-sector pensions

Tackling the bloat

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From The Economist print edition

Why the government cannot duck public-sector pensions reform

OVER the past few years, Labour's spending splurge has made the public sector the place to work. Since 2000, employment has grown by 10% compared with 2% in the private sector. Earnings have risen by 25% compared with 20% in the private sector, according to official figures released on September 14th.

But pay is a modest draw compared with the lure of pensions. For one thing, final-salary schemes, which provide benefits linked to end-of-career earnings and years of service, are still open to new employees in the public sector. By contrast, there has been a wave of closures by private employers.

As a result, the public sector has become the last redoubt of the final-salary scheme, long regarded as the pensions gold standard. In 2004 there were 5m public-sector workers building up such pension rights. This contrasted with 3.6m in the private sector, of whom only 1.9m were in plans still open to new employees.

Many private-sector workers are in defined-contribution plans, in which they build up their own pension savings. Even so, pension-participation rates are much lower than in the public sector. Around 45% of private workers are in employer-sponsored pension schemes, compared with around 85% of public employees.

Not only are participation rates higher in the public sector, but also pensions are more generous. Benefits at retirement are quite similar to a good private scheme. However, they are generally paid at 60 (and for some workers, like fire-fighters and police officers, at 55) rather than the usual age of 65 in the private sector. Furthermore, they are fully protected against inflation whereas the private sector now only offers indexation up to a cap of 2.5%.

Adding to the costs of provision, early retirement on grounds of ill health is much more common in the public sector. “A typical public-sector pension for someone aged 40 is worth half as much again as a typical private-sector final salary scheme,” sums up Chris Curry, research director of the Pensions Policy Institute.

Already, the public sector's share of occupational and personal-pension wealth is double its share of total employment and earnings (see chart). That disparity can only widen as private employers retrench while the public sector continues to offer such generous benefits.

The cost to future taxpayers of public-service pensions, which are unfunded apart from the local-government scheme, is ballooning. In 1995 the commitments were worth £195 billion—27% of GDP. By 2004, they had increased to £550 billion—47% of GDP.

Reform is clearly essential, yet the government ducked confronting the unions before the general election. Faced with a threatened strike by 1.5m public-sector workers, it agreed in March to more talks on its proposals, even though these had first been made in 2002. Now it seems to have regained its nerve. Alan Johnson, the minister heading negotiations with the unions, told the TUC's conference this week that “the retirement at 60 ethos” must change and that schemes must be able to withstand demographic changes.

The key measure is to raise the normal retirement age from 60 to 65, for new workers from 2006, and phasing in the change for existing workers from 2013. This change simply catches up with the increase in life expectancy for people in their early sixties of around five years since the start of the 1980s. It is a belated response to the rise in longevity that has contributed to the spiralling costs of funding pensions in the private sector.

Even with the reform, the annual bill to the taxpayer for unfunded public-service pensions is due to rise sharply. According to the Treasury, the cost will increase from 1.5% of GDP in 2003 to 1.8% in 2013 and 2.1% in 2023. Such estimates, which could well prove optimistic, explain why the government cannot shy away again from long-overdue reform.

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Economist.com WORLD EUROPE

Academics ponder celebrity

Deconstructing Mr Beckham

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An academic conference answers some pressing questions

SOCIOLOGISTS secretly know that their work is unlikely to transport them into the pantheon of celebrity. Jonathan Gershuny of Essex University says he does know one (American) sociologist who has a private jet, but its arrival on the tarmac is unlikely to interest the photographers who work for glossy magazines. Those who do want a little glamour must content themselves with turning celebrities into subjects for theorising, to be filed away in one of the incomprehensible categories that keep sociologists in business.

There was plenty of that going on this week when a group of sociologists met at Ayr racecourse in Scotland to discuss the phenomenon of celebrity. Their host was the University of Paisley, which runs an undergraduate course on celebrity culture, taught in part by a member of a washed-up rock band.

Alongside some papers on the economics and history of celebrity were plenty of attempts to address some of the thorniest problems of 21st-century life. “Postfeminist fatherhood and the paternalization of the Eddie Murphy star image,” was covered by Hannah Hamad of the University of East Anglia. Line Grenier of University of Montreal dealt with “the pragmatics of fame: visibility, public memory and Celine Dion”.

Perhaps inevitably, given that the conference was held in Britain, a whole session was devoted to the meaning of David Beckham, captain of England's football team and almost a global brand himself. Mr Beckham's role as a sex symbol was explored in a paper called “Beckham: how ‘queer' serves ‘heterotopia' in the dialectics of celebrity”.

Worrying about the social consequences of celebrity worship is nothing new, of course. Herbert Blumer studied the effects of films on adolescents in the 1930s and concluded that, “despite their gay and entertaining character, motion pictures seem to enter seriously into the life of young men and women, particularly of high-school age.” Despite the occasional moral panics, most people now reckon that cinema has not turned people into sociopaths. Non-fictional celebrities are probably no more damaging.

What is puzzling, though, is why there is so much demand for celebrity stories and pictures. Mr Gershuny (who was not at the conference) points out that in Britain, as in many other developed countries, there has been a steady increase since the 1960s in the amount of leisure time spent outside the house. And when people are in public places, they need topics for conversation that everyone can share. Gossiping about their neighbours is out, because they may no longer know them. So the vacuum is filled with talk about the private lives of famous people. If only sociologists were that easy to please.

Bagehot

Trying harder

Sep 15th 2005
From The Economist print edition

Tony Blair has one last chance to do something about bad secondary schools

Get article background

BACK from his summer holiday in Barbados, Tony Blair is refreshed, buoyant and brimming with confidence. Gordon Brown is more or less behaving himself. With the exception of a few easy-to-ignore trade union leaders, nobody now seriously disputes his right to go at a moment of his own choosing. The Tories are in effect leaderless until the New Year. Within reason, Mr Blair, unfettered by his decision not to fight a fourth election, can for the moment do just about anything he wants. But scratch below the surface and you will find something else: a frustration that too much time has been wasted and an impatience to do as much as possible with the two, at most three, years left to him.

Nothing triggers those feelings of frustration and impatience more than Labour's failure to improve the bottom 25% of the nation's secondary schools. Mr Blair needs no reminding of the evidence that during his time in office, social mobility has declined. Unhesitatingly, he puts the blame on the education system. For a prime minister who from the outset declared schools to be the government's over-riding priority—who will forget “education, education, education”?—it's quite an admission.

This week, between returning from trade talks in China and flying to New York in a futile attempt to try to fix the United Nations, Mr Blair spent the best part of a day visiting the kind of schools that he now thinks will provide at least part of the answer to an intractable problem—the rotten educational prospects for many children in Britain's inner cities. One was a newly formed federation between a successful City Technology College and a previously failing secondary school in Lewisham, East London; the second, a recently founded City Academy in Bermondsey, sponsored by the Corporation of London, that has just moved into £33m-worth of shiny new buildings.

Apart from being non-selective, both are essentially independent schools that don't charge fees. Next month, the government will publish an education White Paper which will attempt to clear away the obstacles to the creation of many similar schools. How controversial this will turn out to be, nobody yet knows.

Mr Brown rumbles on about the shortcomings of markets. On the other hand, he identified himself strongly with an election manifesto that stated among other things: “We want all secondary schools to be independent specialist schools with a strong ethos, high-quality leadership, good discipline (including school uniforms), setting by ability and high-quality facilities as the norm.” It's a moot point how many Labour MPs took the trouble to understand how radical a statement of intent this was.

The main aim of the new legislation will be, in the words of one minister, “to open up the supply-side” by making it far easier for new providers and sponsors to set up schools—or as Mr Blair said

this week, “to break down monolithic ‘one size fits all' provision”. The key, Mr Blair has decided, is to end the ability of local education authorities (LEAs) and, more particularly, the Orwellian-sounding Schools Organisation Committees (SOCs) to block new schools.

Mr Blair has concluded that new schools often provide a necessary spur of competition to others in their area and improving the worst schools can be impossibly difficult. The SOCs, which were set up by Labour soon after it came into office, could have been designed to reach the opposite view. The fuzzily well-intentioned idea was to give local “stakeholders”, such as faith groups, union representatives and school governors a say in education planning. But because they have to reach agreement by consensus—and there's usually somebody who will reckon a new school poses a threat to an existing one, especially if it is unpopular with parents and suffers from falling rolls—they frequently act to lock in the status quo, however miserable it may be.

Mr Blair's hopes now rest on three legs. The first is an acceleration of the City Academies movement with at least 200 established by 2010 in places where existing schools are struggling. The academies are expected to provide what Mr Blair calls “the empirical test bed” needed to win over doubters. Each one will be centrally funded to the tune of at least £20m, but run by a sponsor who has put up £2m—usually a philanthropic outfit, such as Ark, a charity supported by the profits from City hedge funds that intends to operate seven schools. Although the academies have their critics, this year's GCSE results, which showed an improvement four times the national average, was some vindication. Parents are also queuing up to get their children into them. The second expectation is that nearly all schools will eventually opt for self-governing “foundation” status, which, since this summer, they can do by a simple vote of the governing body. Mr Blair says that foundation schools will have as much operational autonomy as the academies. The third is that lots of other people, including parents' groups, will start up new schools where there is a need for them.

Questions and answers

Inevitably, there are sceptics. How many heads of successful schools will want to take on the extra work and reputational risk of running a federation? How many Arks are there with the resources and skill to set up and run new schools? Will, as now, the middle classes find a way to monopolise the best new schools? Is Mr Blair trying to bring back selection by stealth? What will be the fate of children left behind in failing schools if they are not quickly closed?

Mr Blair's retort is that, as the old model hasn't worked, it's time to try a new one. As one senior Labour MP put it: “Everything else we have tried has failed. Who knows? Perhaps Tony does have some of the answers.” The frustration for the prime minister is that it has taken him so long to find those answers. His impatience is because he has so little time left to put them into action.

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Economist.com SCIENCE TECHNOLOGY QUARTERLY

Inside this quarterly

Sep 15th 2005
From Economist.com

A discussion with Tom Standage, Technology Editor of *The Economist*

"There are a number of things going on in technology which are reflected in different TQ articles. We have a couple of stories about forecasting things you might have thought could not be forecasted, wars and traffic. And some articles look at how new models of decentralised, collaborative innovation are made possible by the internet."

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Economist.com PRINT EDITION TECHNOLOGY QUARTERLY

MONITOR

Watch this space

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Consumer electronics: As mobile phones threaten to depose them as the most personal of technological devices, high-tech watches are fighting back

IT IS a tiny technological wonder that goes everywhere with you. Your choice of brand and model says a great deal about who you are and how you wish to be perceived by others. It may have a classic, bare-bones design, or its sleek casing may conceal a host of extra functions. Ten years ago, this described your wristwatch, which epitomised the combination of fashion and technology for over a century. But today it also describes your mobile phone, which for many people has already dethroned the wristwatch as the most personal of technological devices. Can watchmakers fight back? In recent years there have been several attempts to boost the appeal of watches by adding exotic new functions, from telephones and televisions to personal organisers. But so far, none of these super-watches has been a hit with consumers. Manufacturers, it seems, have tended to ignore obvious practical limitations, and have failed to exploit the unique position of the watch—right there on your wrist.

Consider, for example, the chequered history of attempts to develop a “Dick Tracy” watch with a built-in phone, as used by the 1930s comic-strip hero. Swatch, the Swiss pioneer of low-cost fashion watches, unveiled a prototype called Swatch Talk in 1998, but it has not been seen since. A similar fate befell a Samsung device that was previewed in 2003. In both cases, production plans were shelved when prototypes failed to impress users: holding your wrist to your ear during a conversation and keying in numbers with a toothpick simply look absurd. The Wristomo, a watch-phone made by NTT DoCoMo of Japan which actually made it to market in 2003, provides a partial solution by making the strap part of the phone. Watch and strap unfold into a normal sized phone, but this makes for a rather chunky watch, and the Wristomo has been a flop.

Watches, it seems, are simply the wrong shape for mobile telephony. But what about digital music? One snag is the inconvenience of wires from wrist to ears. The controls also tend to be rather fiddly, and because weight and volume are at a premium in watches, battery life is usually not competitive with larger, dedicated devices such as Apple's iPod. As a result, watch-based MP3 players have also failed to take off. Similar drawbacks have scuppered attempts to integrate personal organisers, digital cameras and other devices into watches.

Yet still they come: gadget freaks can choose from a host of exotic models that would do James Bond proud. Want a wristwatch TV for your daily commute? No problem: NHJ of Japan makes one with a sharp, 1.5-inch colour screen—but the battery only lasts an hour. Still looking for those weapons of mass destruction in Iraq and need a radiation detector? The GammaMaster watch has a handy built-in Geiger counter. Other watches incorporate ultraviolet radiation sensors and satellite-positioning systems.

But such watches appeal only to the geek fringe. Mobile phones, however, suggest that people will adopt new features on a device that originally just did one thing. Millions of people now use their mobile phones to send text messages, take pictures and play games. So perhaps watchmakers need to find new features that play to the strengths of watches. For example, unlike socially disruptive mobile phones, watches are far more discreet. They are also visible at a glance, without the need to fumble in a pocket or briefcase. Watchmakers dream of creating an iconic, breakthrough device that opens up an entirely new category, just as the iPod did.

Hence the launch last year, after many delays, of “smart” watches powered by Microsoft's MSN Direct service. This service, only available in parts of North America, uses an FM radio signal to send news, sports results, stock prices and other nuggets of information to the watch's screen. Many users have their favourite items, including the time, cycling continuously, which allows surreptitious scanning of the latest sports results while sitting in a meeting. The watches can also display alerts from Microsoft's instant-messaging service, and can synchronise calendars with a PC. Four watchmakers backed the initiative: Suunto of Finland, Fossil of Texas, and Tissot and Swatch, both members of the Swatch Group of Switzerland.

The Swatch Group's support for smart watches is significant, since this conglomerate of Swiss watchmakers accounts for some 25% of global watch sales by value. The decision to launch a smart watch under the Tissot brand is particularly revealing, says Pierre Maillard, a veteran observer of the Swiss watch industry and editor of *Europa Star*, a trade magazine. He notes that Tissot sits in the highly profitable mid-market segment which the Swiss have cornered, and is associated with Swiss quality, not cheap gadgetry. The Tissot “High T” smart watch, retailing at over $700, is aimed at status-conscious businessmen, not hip youngsters. Its novel touch-sensitive display is reminiscent of the iPod's nifty scroll wheel.

Most smart watches, however, are still quite chunky, in order to squeeze in the necessary electronics. The need to pay a $40 annual subscription charge is off-putting, too. And the technology has had teething troubles, so its future is unclear.

But whatever becomes of smart watches, the wristwatch still has potential in other areas. For example, because it is normally strapped to its owner, it is harder to misplace than a flash drive or memory stick. This has prompted LAKS, an Austrian firm, to launch a watch with built-in flash memory and a standard USB connector in its strap to enable it to be plugged into a PC. Previously better known for its chic Klimt-inspired watches than for high-tech gadgets, LAKS has seen its sales more than double as a result.

Lucas Alexander Karl Scheybal, the head of the firm that bears his initials, believes this sort of watch has huge potential in e-commerce. Its latest twist on the memory watch, called SmartTransaction, integrates both the USB connector and a secure smart-card chip, like those used in credit cards, with a contactless interface developed by Philips, a Dutch electronics giant. By plugging the watch into a PC, funds or travel tickets can be downloaded to the chip without the need for a special smart-card reader. Being wrist-mounted, a watch is always close at hand, which makes it particularly convenient when operating contactless readers on public-transport systems (such as those used by London's Oyster system). A contactless chip inside a watch might also be the logical place to store e-cash, credit cards and personal medical records. Production of the new watches starts this month.

Swatch also sees great potential for watches as contactless digital wallets. Its Swatch Access contactless technology, launched way back in 1996, has since found several niche applications, including use as an electronic ski pass at hundreds of resorts. Christoph Winkelmann of Swatch says the Access technology is making a big comeback in this year's product line, as the company targets new applications. In July, 64,000 Swatch Access watches functioned as tickets to the opening events of the new Swiss national football stadium in Bern. So perhaps there is a role for the high-tech watch after all. Time will tell.

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MONITOR

Mashing the web

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Software: Programmers are combining data from different websites to create "mash-up" sites with entirely new capabilities

ARMED with a stack of house-listing printouts from Craigslist.com, a popular website, Paul Rademacher was driving around Silicon Valley late last year looking for a place to live. It was not until he was about to park that he looked up and realised he had already visited the same house earlier. Surely, he thought, there had to be a better way to evaluate and visualise a list of housing options.

And so there was. In February, Mr Rademacher—who by day was a software engineer at DreamWorks Animation—began building a website that combines the mapping capabilities of Google's search engine with housing listings from Craigslist. The result, HousingMaps.com, creates maps showing houses or apartments in a particular city within a designated price range. The site went live in April, and is a leading example of one of the latest internet trends: the web mash-up. HousingMaps instantly attracted a crowd and has since been visited by more than 850,000 people.

The term mash-up is borrowed from the world of music, where it refers to the unauthorised combination of the vocal from one song with the musical backing of another, usually from a completely different genre. Web mash-ups do the same sort of thing, combining websites to produce useful hybrid sites and illustrating the internet's underlying philosophy: that open standards allow and promote unexpected forms of innovation.

"Mash-ups are emblematic of the direction of the web," says Paul Levine, the general manager of Yahoo! Local, a subsidiary of one of the web's most popular sites. "This is about participants in the web community opening up their systems." It may also be about good business. By building their sites using open standards, and so making it easier for customers and developers to build other sites that plug into them, companies can both encourage innovation and boost their own popularity. "When you lower the barriers to entry, interesting things happen," says Tim O'Reilly, president of O'Reilly & Associates, a firm based in Sebastopol, California that publishes programming handbooks. "The players who figure this out will wield a great deal of economic power."

As often happens online, this trend is being driven from the bottom up, by users. Most mash-ups happen without the sites that supply the data even knowing about it. For example, Greg Sadesky, a programmer based in Quebec City, grabbed textual data from Yahoo! Traffic and map data from Google without consulting either firm, to create a mash-up (see traffic.poly9.com) that produces traffic maps. Similarly, Chris Smoak, who lives in Seattle, has mashed together several traffic, web-cam, transport-information and map sites to create Seattle Bus Monster, a public-transit site for the Seattle area (see www.busmonster.com). The rise of online journals, or blogs, has spurred the mash-up trend by bringing programmers together to discuss new ideas and tricks. Mr Sadesky credits the inspiration for his traffic-map mash-up to the blog run by John Resig (ejohn.org), which explains how to extract traffic data from Yahoo!'s website.

Mashing is getting easier for these after-hours programmers as big websites start to cater to their needs. ChicagoCrime.org, a mash-up that lets visitors view crime data by street, date, type and zip code on a map of Chicago, for example, said at the end of June that Google's decision to release an official method for linking to its maps had made the site far more reliable. Yahoo! opened up its map data in a similar way in June, and in July Microsoft unveiled a pre-release version of its mapping site, MSN Virtual Earth. It includes a “Community” button to help programmers create websites that incorporate data from Virtual Earth.

Such firms are happy to see their sites get mashed. At the Where 2.0 conference in San Francisco this summer, Brett Taylor, the product manager of Google Maps, noted that “everyone is doing it already”—so why fight it? “A mash-up lets a company like Google tap into the creativity of the world's programmers,” says Nathan Torkington of O'Reilly Media, who was the conference chairman.

So will mash-ups march on? Only if they lead to revenue, some predict. “Something has to evolve,” says Craig Donato, the founder of Oodle, a site with local buying, selling and donation listings. If the information being mashed is useful, he says, it is probably expensive for the originated sites to put on the web in the first place. At the Where 2.0 conference, Mr Taylor of Google said that programmers were free to use Google maps for mash-ups that were “free to consumers”—but added that his firm reserved the right to deliver maps with advertisements on them in future. Dave McClure of Simply Hired, a recruitment site based in Silicon Valley, says he expects the mash-up scene to change, just as the blogging scene did when Google's advertisement-placing service, AdSense, first appeared and “turned free content into a monetisable data source”.

There are already signs that mash-ups have commercial potential. Simply Hired and the social-networking site LinkedIn, for example, have already mashed themselves together. If you are a member of LinkedIn and go searching for a job on Simply Hired, you can link from a job listing to a list of LinkedIn contacts who could get you an introduction at the company in question. As well as helping users to land a job, this mash-up should help the two websites to boost their traffic. And in August, Salesforce.com, a pioneering provider of business software that runs inside web browsers, announced Smashforce, an initiative to make it easier to incorporate its software into mash-ups. A firm could, for example, combine a list of sales prospects with a map, to help a salesman plan his route.

All told, the urge to mix things up should keep companies and programmers busy for the foreseeable future—too busy, sometimes, even to use their own mash-ups. Mr Smoak, who created his mash-up during evenings and weekends, says he never gets up early enough to take the bus to his day job, at Amazon. “I'm not an early riser,” he says. “But if I stay up late I can do projects like this.” And what of Mr Rademacher's housing search? The popularity of his website helped land him a job at Google, but has also kept him so busy that he has not had time for any more house-hunting.

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MONITOR

Sailing ships with a new twist

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Transport: Giant kites that act like sails could bring wind propulsion back to ocean-going ships, reducing emissions and saving on fuel costs

Masts? Who needs them?

IN THE first half of the 19th century, ships began to adopt steam engines, first alongside and then instead of sails. Today, wind propulsion is for sportsmen and romantics, not shipping firms trying to make money. But the high price of oil and stricter pollution regulations are strong forces working to turn back the clock. Wind propulsion is coming back in a new form: kites, not sails. Next year, SkySails, a German firm based in Hamburg, will begin outfitting cargo ships with massive kites designed to tug vessels and reduce their diesel consumption. The firm estimates that these kites will reduce fuel consumption by about one-third—a big saving, given that fuel accounts for about 60% of shipping costs.

The idea of reintroducing sails to modern ships is not new. A Japanese consortium tried it in the 1970s, but got nowhere. In the 1990s, the Danish government launched Project WindShip, but it was scuttled in 1998. Other teams met failure, too. The insurmountable problem in each case proved to be the mast.

In unfavourable winds, large masts create a lot of drag. In gales, masts cause ships to heel, sometimes dangerously. Masts and their pivoting sails take up valuable container space on the deck. Loading and unloading is more expensive, since the cranes that lift containers must work around the masts. Engineers designed taller (and more expensive) masts, some exceeding 100 metres in height, to reduce their number and limit the loss of storage space. But the Panama Canal limits masts to 60 metres, and collapsible masts would be prohibitively expensive to build, operate and service.

Knud E. Hansen, the naval engineering firm based in Copenhagen that led Project WindShip, designed high-tensile steel masts with foldable carbon-fibre sails, known as vertical aerofoils because they generate horizontal thrust just as aeroplane wings create lift. The cost of retrofitting a cargo ship with a row of masts, and strengthening its hull and deck to dissipate the additional stress, was estimated at *euro*10m ($12.5m). So the sails would have taken around 15 years to recoup their costs through fuel savings.

But the SkySails approach does away with masts and is much cheaper. The firm says it can outfit a ship with a kite system for between €400,000 and €2.5m, depending on the vessel's size. Stephan Wrage, the boss of SkySails, says fuel savings will recoup these costs in just four or five years, assuming oil prices of $50 a barrel. Jesper Kanstrup, a senior naval architect at Knud E. Hansen, says the idea of pulling a ship with an inexpensive kite—attached to the structurally solid bow like a tugboat—had never occurred to him. “It's a good idea,” he says.

SkySails' kites are made of a type of nylon similar to that used in the sails of modern windjammers, but they fly between 100 and 300 metres above sea level, where winds are less turbulent and, on average, more than 50% stronger than the winds that sails capture. An autopilot computer adjusts the height and angle of the kite, the surface area of which can range from 760 to 5,000 square metres. When the wind blows too strongly, one end of the rectangular kite is released so that the kite flaps like a flag. A powerful winch retrieves the kite when necessary.

Regulators, as well as cost savings, could boost the technology. For while both Europe and America have strict regulations on vehicle pollution, ships have enjoyed something of a free ride. Moving one tonne of goods one kilometre by ship, for example, releases about 225 times as much sulphur as trucking the goods the same distance, according to the Secretariat on Acid Rain, a Swedish pressure group. Mario Dogliani, the head of research at RINA, an organisation based in Genoa that inspects and certifies ships, says European regulators are “really pushing” for tougher emission controls, backed up with stiff fines, for shipping. “We need to innovate,” he says.

In May, the International Maritime Organisation's new rules on marine pollution took effect. They require many ships to switch to a low-sulphur fuel that costs 50% more than traditional (and highly polluting) fuel oil. And an increasing number of ports now offer discounts for ships with approval labels, called Green Passports, awarded by environmental groups. It all adds up to a favourable wind for SkySails.

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The doctor in your pocket

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Medical technology: Nearly everyone in the developed world carries a mobile phone—so why not use it to deliver health care?

GARY KATZ is a repeat offender. A few years ago, a nutritionist helped him to reduce his blood-cholesterol level from a troubling 286 to a reasonable 177. But after his annual check-up in April, Mr Katz found that his cholesterol was once again too high. The businessman turned to the same nutritionist as before, but now he and his food adviser have a secret weapon: the mobile phone.

Through a new service called MyFoodPhone, Mr Katz uses the camera built into his phone to take a picture of every meal. This is far easier than writing everything down in a food log, which the 44-year-old New Yorker did the last time he was fighting high cholesterol. At the end of each week, his nutritionist e-mails him a dietary critique. “I was never one for the whole food-log thing,” says Mr Katz, who owns a floor-covering business. “Now I'm doing better at keeping track of what I eat. I always have my phone with me—it's like having a conscience hanging on your waist.”

The notion of procuring health care via phone is not new: when doctors routinely made house calls, medical help was just a phone call away. “Most health-care services today are delivered inside medical premises,” says José Lacal of MotoHealth, the health-telemetry project run by Motorola, the world's second-biggest mobile-phone manufacturer. “But with the mobile phone, you can take the services with you.” HBS Consulting, a consultancy based in London, estimates that the global “telehealth” market—the use of telecommunications and information technology to deliver health care and related services—will grow to $7.7 billion in 2006, up from $3.2 billion in 2003.

So far, most mobile telehealth services, such as MyFoodPhone, simply use ordinary mobile phones to collect and transmit data. The next stage is to add specific medical sensors, which can even be incorporated directly into the handset. For example, LG, a South Korean handset-maker, started selling a phone with a built-in blood-glucose meter, for use by diabetics, in its home market last year. It can transmit blood-glucose readings to a doctor, parent or desktop computer for further analysis. Healthpia America, based in Newark, New Jersey, plans to launch the phone in America in January.

Motorola and Partners Telemedicine (a division of Partners HealthCare, a group of hospitals and health-care providers in Boston) have been testing devices that can transmit a patient's weight, blood pressure and other data. Weighing scales and blood-pressure monitors communicate via Bluetooth (a short-range radio technology) with the mobile phone, which then sends the data to the doctor. Clinical trials are under way in Barcelona and Boston, says Mr Lacal, with potential commercialisation as early as next year.

In Britain, a joint-venture between the Institute of Biomedical Engineering at Imperial College London, Toumaz Technology and Oracle, the world's second-largest software firm, has devised a “pervasive monitoring system” that will enter trials in 2006. A small sensor, attached using a sticking plaster, monitors the patient's heartbeat and detects irregularities. The resulting electrocardiogram data is sent wirelessly to a nearby mobile phone, which then transmits it to a monitoring centre, or directly to a doctor.

Mobile telehealth need not be so elaborate, however. SIMpill, a South African firm, makes a small device that clips on to a medication bottle and sends a text message to a central computer whenever the cap is removed. If no message arrives, the central computer sends a text-message reminder to the patient, or to a family member or carer. The system is now used by more than 2,000 people and can dramatically improve compliance, says SIMpill's founder, David Green. It has just been launched in America.

Many observers expect mobile telehealth to take off in mobile-loving South Korea and Japan, but to lag behind in America, where consumers are more likely to raise privacy concerns. But Donald Jones, head of mobile health care at Qualcomm, a wireless-technology firm based in San Diego, notes that phones' built-in security features make them far more secure than PCs.

Besides, the need for tools to improve the management of chronic health conditions cannot be overstated. According to America's Centres for Disease Control and Prevention, more than 90m Americans have a chronic illness, and they account for over 75% of the nation's $1.4 trillion annual spending on health care. So the mobile phone could be a useful tool to combat both chronic disease and runaway medical costs. Joseph Kvedar of Partners Telemedicine, who is also a professor at the Harvard Medical School, suggests that insurance companies might, for example, offer free phone minutes to customers who go for a walk every day. Their compliance would be monitored by a pedometer built into the handset.

Mobile phones' impact on health care could be even greater in the developing world, where mobiles far outnumber PCs. “For most of the world”, says Mr Jones, “this is the only computer they are ever going to own. It's on the internet. And they carry it everywhere.” Get ready for the doctor in your pocket.

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Summer camp for coders

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Software: Google's new scheme keeps young geeks busy over the summer and boosts open-source development

“I'M A total geek all around,” says Angela Byron, a 27-year-old computer programmer who has just graduated from Nova Scotia Community College. And yet, like many other students, she “never had the confidence” to approach any of the various open-source software communities on the internet—distributed teams of volunteers who collaborate to build software that is then made freely available. But thanks to Google, the world's most popular search engine and one of the biggest proponents of open-source software, Ms Byron spent the summer contributing code to Drupal, an open-source project that automates the management of websites. “It's awesome,” she says.

Ms Byron is one of 419 students (out of 8,744 who applied) who were accepted for Google's “summer of code”. While it sounds like a hyper-nerdy summer camp, the students neither went to Google's campus in Mountain View, California, nor to wherever their mentors at the 41 participating open-source projects happened to be located. Instead, Google acted as a matchmaker and sponsor. Each of the participating open-source projects received $500 for every student it took on; and each student received $4,500 ($500 right away, and $4,000 on completion of their work). Oh, and a T-shirt.

All of this is the idea of Chris DiBona, Google's open-source boss, who was brainstorming with Larry Page and Sergey Brin, Google's founders, last year. They realised that a lot of programming talent goes to waste every summer because students take summer jobs flipping burgers to make money, and let their coding skills degrade. “We want to make it better for students in the summer,” says Mr DiBona, adding that it also helps the open-source community and thus, indirectly, Google, which uses lots of open-source software behind the scenes. Plus, says Mr DiBona, “it does become an opportunity for recruiting.”

Elliot Cohen, a student at Berkeley, spent his summer writing a “Bayesian network toolbox” for Python, an open-source programming language. “I'm a pretty big fan of Google,” he says. He has an interview scheduled with Microsoft, but “Google is the only big company that I would work at,” he says. And if that doesn't work out, he now knows people in the open-source community, “and it's a lot less intimidating.”

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Held aloft by hydrogen

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Aviation: An unmanned aircraft powered by hydrogen has taken to the air for the first time. Such aircraft could have both military and civilian uses

BLAME it on the Hindenburg. Ever since the hydrogen-filled German airship exploded in 1937, hydrogen and aviation have not had much to do with each other. But a new aircraft, which made its first flight in May, could change that. *Global Observer*, the world's first liquid-hydrogen powered, unmanned-aerial vehicle (UAV), is not an airship, but an aeroplane that uses hydrogen as a fuel. It was built by AeroVironment, a firm based in Monrovia, California, which announced at a UAV conference in June that *Global Observer* had made its first flight above the desert sands of Yuma, Arizona.

Having pioneered solar-powered flight in the 1990s with America's space agency, NASA, AeroVironment has since refocused its efforts towards fuelled UAVs. Solar-powered UAVs promise potentially unlimited hours in the sky, but they have limitations. At latitudes above 45°, and during the winter, the sun is too weak to keep the aircraft flying. Liquid hydrogen is an attractive fuel for a high-altitude, long-endurance vehicle, since it has around three times as much energy per unit of mass as conventional jet fuel. The difficulty is keeping it liquid, since hydrogen boils at -253°C. *Global Observer* has a special insulated storage tank that can hold enough liquid hydrogen to keep the plane aloft for 24 hours. The hydrogen is combined with oxygen from the air in a fuel cell, producing electricity that drives the aircraft's propellers and powers its onboard systems. The aircraft is a scaled-down version of a much larger aircraft that would be able to stay aloft for more than a week.

Such an aircraft would have a number of uses as a low-cost alternative to satellites. Equipped with wireless-broadband relays, imaging equipment or monitoring devices, it could be used for surveillance, weather monitoring and telecommunications. In 2002, AeroVironment demonstrated the use of a solar-powered UAV as a mobile-phone relay and a TV broadcasting platform, in

conjunction with NEC, Toshiba and other Japanese firms.

Ted Wierzbanowski, AeroVironment's managing director, admits that many people were sceptical about the switch to hydrogen. “Building the prototype was the only way to put the hydrogen bogeyman to bed,” he says. “We think this is a big paradigm shift in the aerospace and space industry.” The prototype aircraft has a 15-metre wingspan, but he expects two production versions, with 46-metre and 76-metre wingspans. Loitering at altitudes of between 18,000 and 21,000 metres, they would work in threes: as one plane started to run out of fuel, another would take off, to ensure continuous broadband or TV coverage.

But several challenges remain. One of the biggest is reliability, according to John Del Frate, the former manager of NASA's Environmental Research Aircraft and Sensor Technology project. “Most commercial aircraft have to be inspected every 100 or 200 hours,” he says. “In one flight of these hydrogen and solar-powered vehicles, we'll easily exceed that amount.” Worse, the aircraft must be able to withstand ultraviolet radiation, freezing temperatures and high winds, says Mr Del Frate, though AeroVironment claims to have addressed these problems.

Then there is the small matter of convincing potential buyers, such as Colonel Patrick Rhodes, the commander in charge of America's Air Force Space Command “Battlelab”, which tests new technologies for the military. For the moment, he says, “hydrogen-powered lighter-than-air and heavier-than-air vehicles that will provide significant persistence over an area are not there yet.” But Major-General Douglas Fraser, director of air and space operations for Air Force Space Command, is optimistic that the new UAVs will eventually prove themselves.

The new aircraft also faces competition from rival technologies, such as the “Stratellite”, a helium-filled airship being developed as a communications relay by GlobeTel Communications, a firm based in Florida. Mr Wierzbanowski reckons his approach has lower running costs, but airships can lift larger payloads. So there may be room in the stratosphere for both technologies.

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A new way to stop digital decay

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Computing: Could a "virtual computer", built from software, help to save today's digital documents for historians of the future?

WHEN future historians turn their attention to the early 21st century, electronic documents will be vital to their understanding of our times. Old web pages may not turn yellow and brittle like paper, but the digital documents of today's culture face a more serious threat: the disappearance of computers able to read them. Even a relatively simple electronic item, such as a picture, requires software to present it as a visible image, but 100 years from now, today's computers will have long since become obsolete. More complex items, like CD-ROMs or videos, will be unreadable even sooner.

In 1986, for example, 900 years after the Domesday book, the BBC launched a project to compile data about Britain, including maps, video and text. The results were recorded on laserdiscs that could only be read by a special system based around a BBC Micro home computer. But since the disks were unreadable on any other system, this pioneering example of multimedia was nearly lost for ever. It took two and a half years of patient work with one of the few surviving machines to move the data on to a modern PC (it can be seen online at www.domesday1986.com).

National libraries are just starting to grapple with this problem as part of their new mandate to preserve digital culture. "It is a major problem, but it is remarkable how little known it is," says Hilde van Wijngaarden, head of digital preservation at the National Library of the Netherlands. "People just accept that things no longer work after ten years."

Keeping working examples of all computer hardware is impractical, so the most popular preservation strategy is to copy files from one generation of hardware to the next. The problem is that today's word processors and web browsers, for example, do not always display files in the same way that older software did. An accumulation of subtle errors can eventually make the original item unreadable. An alternative approach, called emulation, uses software to simulate the old hardware on a modern computer, to allow old software to run. But today's emulators will need another emulator to run on the next generation of hardware, which will need another emulator for the next generation, and so on. This can also introduce errors.

So the National Library of the Netherlands is exploring a third option, using a simulated computer that exists only in software. It is called the Universal Virtual Computer (UVC) and is being developed by IBM, a computer giant. The researchers are writing programs to run on this virtual computer that decode different document formats. Future libraries will have to write software that emulates the virtual computer on each new generation of computer systems. But once that is done, they will be able to view all their stored documents using the decoders written for the virtual computer, which only have to be written once. "The decoder can be tested for correctness today, while the format is still readable," says Raymond van Diessen of IBM.

His team has written decoders for two common image formats, JPEG and GIF. They plan to move on to Adobe's PDF format. IBM is also talking to drug firms, which are required to store data from

clinical trials for long periods. Ultimately, the aim is to be able to preserve anything from simple web pages to complex data sets. Ominously, some scientific data from the 1970s has already crumbled into unreadable digital bits.

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The policeman on your dashboard

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Transport: A new satellite-based driver-monitoring scheme could provide a glimpse of the Big Brotherish future of motoring

FOR years, traffic police and motorists have been engaged in an arms race. As the police have adopted speed guns and roadside cameras, drivers have taken to radar detectors and maps showing camera locations. But a new system being developed in the United Arab Emirates (UAE) could hand ultimate victory to the traffic police. The UAE is investing $125m in a system that will make it possible to determine the speed of any of the Gulf state's 2m vehicles, no matter where they are. New devices, now being developed by the UAE's Centre of Excellence for Applied Research and Training (CERT) in conjunction with IBM, should be ready for installation in cars within four years.

Once fitted, these devices will use global positioning system (GPS) satellites to determine the car's location to within a few metres, says Farid Metwaly of IBM. By combining several position and time measurements, it is a simple matter to determine the car's speed. This can then be compared with a database of speed limits for all roads in the country. If the vehicle is breaking the local speed limit, the system will issue an audible alert, warning the driver to slow down. “It gives you ten seconds to slow down, and if no action is taken it will issue another warning,” says Mr Metwaly. “If you still don't slow down, it will record the event.”

What happens next remains to be seen. The system will be able to inform a central government server of such “events” via the mobile-phone network. But whether that information will be used to issue speeding fines, or simply retained for statistical purposes, is unclear. “It is for the country to decide what to do with this information,” says Mr Metwaly. There is no doubt about the motivation behind the new system, however. The UAE has one of the worst road-safety records in the world: compared with most European countries or America, there are more than six times as many deaths per passenger mile on its roads.

The prospect of having a policeman on the dashboard might seem a little Big Brotherish to some people. But the UAE project may merely offer a glimpse of what regulators in other countries are also planning. Switzerland and Germany have already introduced automatic road-toll systems for freight vehicles. These are widely seen as a prelude to extending similar measures to cars. The British government has suggested replacing its current road-tax scheme with a satellite-based “pay as you drive” system for all vehicles. The UAE system will also be used for road-taxing and for car-insurance purposes, says Tayeb Kamali, the chief executive of CERT. But it has not yet been decided whether charges and insurance premiums will be based on distance, time of travel or route taken.

Nor is it clear how the system will be rolled out. “I don't think you can make it compulsory,” says Dr Kamali. But who would volunteer to have such a technological tattle-tale installed? It is all a matter of incentives, says Mr Metwaly: cheaper tax and insurance, perhaps, and the ability to determine the vehicle's position in the event of an accident.

Another crucial issue is accuracy. If, as Dr Kamali says, the system is to be able to tell when a driver runs a red light, then the accuracy will have to be good enough to stand up in court. The UAE project will test not just new technology, but new business models and regulations too.

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Hear no evil

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Digital media: Can an "open source" approach be applied to the music business? Magnatune, an innovative record label, thinks it can

IF, AS many people hope, the internet means that the major record labels will gradually become obsolete, what exactly is going to displace them? Apple's iTunes is clearly a part of the future, but it is arguably just a new distribution channel for the major labels' 50-year-old system of big stars and massive marketing budgets. A more radical answer is Magnatune, an independent online record label founded in 2003 by John Buckman. It has all the ingredients that could help future artists bypass traditional labels, earn more money and enjoy greater artistic freedom.

From a listener's point of view, the firm's website is enticing. You can legally listen, free of charge and with high sound quality, to full albums by any of the 200 or so artists who have signed to the label. (Your correspondent was immediately hooked by a song called "Making Me Nervous" by a one-man electro-pop band from Ottawa called Brad Sucks.) Music streamed is free, but to download it to your computer or burn CDs, you have to pay. Just how much is a matter of choice—Magnatune allows you to decide what the music is worth, and to pay as little as $5 for an album or as much as $18. Once paid for, the music is not locked up using "digital-rights management" software, so you are not prevented from making copies. Instead, Magnatune relies on its customers' loyalty to its artists not to pirate their music indiscriminately.

Mr Buckman likens this community-based, free-wheeling approach to that of Linux, the open-source operating system, although the analogy is inexact: Magnatune's customers do pay for music, you cannot remix and redistribute it, and the company does make a profit. What is more Linux-like is Magnatune's desire to unseat the industry incumbents and change the rules of the

game by giving the artists a fairer, less restrictive deal.

Magnatune's slogan, “We are not evil”, owes a debt to Google's slogan (“Don't be evil”) and is a sideswipe at the major labels. Its contract is non-exclusive, so musicians are allowed to carry on selling their music elsewhere. And the label gives artists half of the revenues from what they sell online. Major labels typically give 10% or less.

Most of the artists on the site are professional musicians, and many have been signed at some point to the “evil” kind of record label. Some, like Trevor Pinnock, a conductor and harpsichordist, are famous, but others are unknowns who sent in a demo. Magnatune has a dedicated “artists and repertoire” (A&R) man, and gets about 400 submissions from new artists each month, from which it signs five or ten. It restricts itself to seven main genres—classical, electronica, jazz and blues, metal and punk rock, new age, rock and pop and world. Some genres are dying out in the world of physical CDs, says Mr Buckman, and Magnatune will soon be one of the few places you can find them. He is also a devotee of early classical music, which has a strong presence on Magnatune. Around 10,000 people visit the site every day, and one in 42 visitors buys some music—a far better ratio than the average for e-commerce (where conversion rates are typically between 1 in 400 and 1 in 1,000), and not much worse than in bricks-and-mortar music stores, where it takes 20 customers to generate a sale.

Magnatune has exceeded Mr Buckman's expectations in music licensing, another side of the business that has played a big part in helping it reach profitability. For non-commercial use, such as a school project, the site allows music to be used under a “Creative Commons” licence, a concept devised by Lawrence Lessig, a law professor and crusader for internet freedom. For commercial use, Magnatune makes licences available quickly and cheaply online. This business is growing at 30%, as Magnatune has become popular with independent filmmakers looking for soundtracks.

Though plenty of commentators have seized upon Magnatune as the online music model of the future, Mr Buckman has relatively modest aims. “We're going to stick to second-tier genres and we're not going after the majors,” he says. For now, that is probably realistic, since like other internet-music ventures, Magnatune's weakness is that it does not have the resources to propel its artists into the mainstream via radio and television. For that reason, says Mr Buckman, it tends not to get musicians in their 20s sending in music. “They have an unpleasant attitude and still think they'll get the limo and the drugs,” he says.

So artists considering the 50/50 split should remember that Magnatune is, for now at least, a fairly passive label. In contrast, says Brad from Brad Sucks, “the majors front all that money and take a lot of risk and they do deserve to get some money back.” Any artist on Magnatune who was offered a deal with a major would jump at the chance, says Costa Pilavachi, president of Decca Music Group, a classical label owned by Universal Music Group, the world's largest major label.

This month Magnatune is introducing a new marketing strategy: if you buy some music, you are allowed to give it to three friends—another nod in the direction of the “share and share alike” spirit of the open-source movement. And even if Magnatune itself turns out not to be the web-powered destroyer of the major labels that everyone is waiting for, other, different models will come later. Even Warner Music, one of the majors, is said to be planning to launch an internet-only “e-label” later this year. It will only take one rock star born on the internet, after all, for everyone to pronounce the old model completely dead.

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Building a better battery

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Energy: As portable devices become ever more elaborate and demand ever more power, will battery technology be able to keep up?

JUST as you can never be too rich or too thin, you can never have a battery that lasts too long. But as mobile devices accumulate new power-sapping features, battery technology has been struggling to keep up. This led Yrjö Neuvo, the chief technologist at Nokia, the world's largest handset-maker, to warn of an impending mobile-energy crisis last year. But now several new developments could be about to come to the rescue.

In February, Altair Nanotechnologies, a small firm based in Reno, Nevada, announced a new kind of lithium-ion battery, the technology that powers many portable devices. Its prototype has three times the capacity of existing batteries and can be fully charged in six minutes.

Lithium-ion batteries are so named because during charging and discharging, lithium ions migrate between the battery's positive electrode (anode) and negative electrode (cathode). Altair's trick was to coat the anode with lithium-titanate nanocrystals, says Roy Graham, the company's development director. This enlarges the surface area of the anode from around three square metres per gram to 100 square metres, increasing the capacity of the battery and boosting the rate at which ions are able to move to and from the anode, which is what determines how long it takes to charge. In June, Altair secured a $477,000 grant from America's National Science Foundation to further its design by using nanoparticles on both electrodes. This could further increase power density and reduce charging time, says Mr Graham.

Hard on the heels of Altair's announcement, Toshiba revealed that it too has developed a battery using nanotechnology that is capable of charging to 80% of full capacity in one minute. The company is still working on improving the stability and reliability of the design, but plans to start selling the new batteries next year. Hiroko Mochida of Toshiba says the initial uses will be in electric cars and power tools, where high capacity and rapid charging are particularly necessary. Toshiba will not go into detail about its new design, but, like Altair's, it seems to use nanoparticles to increase the surface area of the electrodes.

There have also been recent improvements to a completely different kind of battery design, known as “beta voltaic” technology. Such batteries use beta particles from a radioactive source to generate a current in semiconductor material, in much the same way that photons liberate electrons to generate a current in photovoltaic solar cells. Batteries of this type can run for years, and are used in devices such as space probes and pacemakers, where changing the battery is impractical. Beta voltaics are safe and reliable but are limited by very low energy yields, says Philippe Fauchet of the University of Rochester in New York.

Now his team has developed a way to increase the power output tenfold, by increasing the surface area of the exposed semiconductor. Instead of a flat surface, his design uses a type of porous silicon, the surface of which is riddled with tiny pits. The radioactive gas within the pits is then almost entirely surrounded by the semiconductor, increasing the chances of catching the beta

particles.The technology is now being developed by BetaBatt of Houston, Texas, which co-developed the new design. There is a growing demand for long-life batteries in medical applications, he says.

It all sounds promising. But no matter how hard researchers work to cram more energy into batteries, they are vastly outnumbered by other researchers dreaming up new ways to consume it.

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MONITOR

No jam tomorrow?

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Transport: New techniques are being developed to spot existing traffic jams, predict future ones, and help drivers avoid both kinds

IS SITTING in traffic as inevitable as death and taxes? Perhaps not. Many countries now have dedicated traffic-monitoring centres linked to networks of cameras and sensors. Throw in traffic-spotting aircraft, accident reports and the known positions of buses fitted with satellite-positioning gear, and it is possible to see exactly what is happening on the roads. Drivers could switch from busy to quiet routes and avoid congestion—if only they had access to this information.

And now they do. Systems such as the Traffic Message Channel and the Vehicle Information and Communication System (VICS), in Europe and Japan respectively, pipe data from traffic centres into in-car navigation systems via FM radio signals. Drivers can see where the traffic is and try to avoid it. Honda, a Japanese carmaker, even combines VICS data with position data from 150,000 vehicles belonging to members of its Premium Club so that they can choose the fastest lane on a congested road, says David Schrier of ABI Research, a consultancy.

Meanwhile ITIS, a British company, is one of several firms experimenting with mobile-phone signals to monitor traffic on roads that lack sensors or cameras. Its software hooks into a mobile operator's network and uses a statistical approach to deduce traffic speeds as phones are “handed off” from one cell tower to another. The data must be cleaned up to exclude pedestrians and cyclists, but this idea has great potential, says Mr Schrier.

Another way to dodge traffic is to predict where and when it will form. In Redmond, Washington, at the headquarters of Microsoft, employees have been testing a traffic-prediction system called JamBayes. Users register their route preferences and then receive alerts, by e-mail or text message, warning them of impending gridlock. JamBayes uses a technique called Bayesian modelling to combine real-time traffic data with historical trends, weather information and a list of calendar events such as holidays. Eric Horvitz of Microsoft, who developed the system, says it is accurate 75% of the time, and 3,000 employees use it daily.

A system called Beat-the-Traffic, developed by Triangle Software of Campbell, California, with funding from the National Science Foundation, goes further. It not only warns drivers of impending traffic but also suggests an alternative route via e-mail or text message. Andre Gueziec, the firm's boss, thinks traffic forecasts will become as prevalent as weather forecasts. Indeed, in June, KXTV News 10, a TV station in Sacramento, California, began showing Triangle's traffic forecasts for the coming week.

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MONITOR

Websites of mass description

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From The Economist print edition

Social software: New “tagging” websites make it easier to share content, find items of interest, and form online communities

Flickr fans put themselves in the picture

THE images flicker across the screen, one every few seconds: a bed, its ruffled covers pulled back to reveal a lonely emptiness; two pairs of lips gently touching, on the verge of a kiss; a lamb playfully nuzzled beneath its mother's belly; two little girls whispering secrets to one another. The photographs come from a college student in Oklahoma, a middle-aged man from rural England, and a Dutch woman, none of whom has ever spoken with or met any of the others. Each photo takes its place among the rest simply because it has been “tagged” by its photographer with the word “intimacy”.

The photographs form part of a slideshow on Flickr.com, a website that allows its users to store, manipulate and share their digital photos. While such sites have been around for years, Flickr stands out because it makes it easy for users to categorise, search and share photos through “tags”—one-word descriptions that capture the essence of a photograph. A tag can be a name or a place, an adjective or a verb, concrete or abstract.

More importantly, though, tags allow Flickr and other sites that rely on them to harness the social power of the web. Give users the option to make their content public, and the ability to search everyone else's content for a given tag, and a world of possibilities opens up. As thousands of users tag photographs and web pages, information begins to percolate in new ways. Users themselves build a database of what is useful and important for others to draw upon. For example,

a search for the tag “love” on Flickr brings up almost 20,000 photos that encapsulate people's idea of love.

What Flickr does for photographs, del.icio.us (pronounced “delicious”) does for bookmarks, by providing management of bookmarked web pages. Hundreds of thousands of registered users have so far linked to over 10m web pages. Traditionally, bookmarks are stored within a web browser on a computer, and can only be accessed from that particular computer. With del.icio.us, users add bookmarks to their personal del.icio.us web page simply by entering the address of a web page and typing in a few words to tag it. The bookmarks can then be accessed from any computer. A user can surf cooking sites and tag “recipes” at the office, for example, and then easily access them from home.

For each bookmark, users can also see how many other users have bookmarked it and who they are. If another user's interests seem similar, their bookmarks can be called up to find new, unexplored sites. All of the bookmarks collected by all users can also be searched by tag, and the most popular links at a given time give a glimpse of the web in motion. With Yahoo! or Google, a mindless software “spider” is sent out to traverse the web looking for new pages. With del.icio.us, an army of people sitting in their homes and offices does the same, tagging web pages as they go along.

Because tags make it easy to share content, users of Flickr have also begun to interact with their photos in new and interesting ways, as communities have formed around particular tags. These communities of convenience are not based on real world connections or networking, but rather on bits of content. Consider the tag “memorymaps”, for example. Memory maps are digital scrapbooks that make use of another feature of Flickr—the ability to annotate photographs with boxes which display pop-up captions when the mouse pointer rolls over them. Starting with a satellite image of a city or town, users attach captions to places of particular significance: their old school-friends' houses, for example. The memory map can then be shared with friends or added to by others who live in that city. Users of another tagging site, Tagzania.com, sprinkle maps with restaurants, bars and other places of interest.

After the London terrorist bombings in July, a Flickr group quickly formed to share photos of the aftermath. Since users can upload photos directly to the site from mobile phones and add comments to photos, an image of a tube ticket bought at King's Cross station on July 7th became a forum for people to share their thoughts and offer their condolences.

Other users simply want to have fun. The “infiniteflickr” tag invites people to contribute photos of themselves looking at Flickr photos of people looking at Flickr photos—*ad infinitum*. The Flicky Awards group votes for its favourite photos in different categories (self-portraits, underwater photography, and so on). A group calling itself “It's the Crew” uses Flickr to make bizarre online comic books. Photos are doctored using Photoshop, have captions added, and tell a story when viewed as a slideshow.

MAKE, a magazine geared toward hobbyists who like to play with and modify technology, has embraced both Flickr and del.icio.us as new ways to interact with readers. Writers contribute useful links and photos of projects as they research and write their stories; readers view and add to them as they work on projects of their own.

Is it all just another internet fad? In March, Flickr was acquired by Yahoo!, and in July Yahoo! launched MyWeb 2.0, a del.icio.us-like bookmarking site. Other tagging sites have sprung up that let users catalogue book recommendations or restaurant reviews. Technorati.com, which has been tracking blog entries using tags since 2002, now lets users search through Flickr photos and del.icio.us links as well. Having brought together social software, blogging and search, the idea of social searching (and tagging) looks as though it is here to stay.

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RATIONAL CONSUMER

Gaming's next level

Sep 15th 2005
From The Economist print edition

Consumer electronics: How will the next-generation games consoles differ, and how can they attract new gamers?

ARE you a PlayStation person, an Xbox aficionado or a Nintendo nut? You may not play video games at all, of course. But if you do, you will be aware that each of the three main games consoles has strengths and weaknesses that make it appeal to a particular audience.

Of the current console line-up, Sony's PlayStation 2 is the most popular machine, with the broadest choice of games. Its success is the result of several factors, including Sony's decision to launch the PlayStation 2 earlier than its two rivals, which gave it an insurmountable head start; its support for older games written for the original PlayStation console; its ability to function as a DVD player; and Sony's close partnerships with games publishers, which ensured a stream of popular titles. All of this enabled Sony to garner a 70% global market share.

But the two other current consoles have devoted fans as well. Nintendo's GameCube has a far narrower range of games than Sony's console, but what it lacks in quantity it makes up for in quality, at least for the family-oriented audience that Nintendo targets. Most of the best GameCube games, such as the Mario and Zelda franchises, are published by Nintendo itself, since third-party publishers have not really embraced the GameCube. But because Nintendo has very high production standards, the games that are available are impressive. And because most of the money in the games industry is made from software, not hardware, Nintendo makes the most profit among gaming firms, even though it has only a 15% market share, notes Paul Jackson of Forrester, a consultancy.

Microsoft, in contrast, has yet to turn a profit from its expensive foray into gaming. As the last of the three consoles to reach the market, the Xbox is easily the most powerful, so it appeals to hard-core gamers. After a slow start it now has an impressive line-up of games, including the “Halo” series of sci-fi shoot-'em-ups, which are not available on any other console. The Xbox also has by far the best online-gaming service, Xbox Live, which is run by Microsoft itself. All of this has helped the Xbox to do well in America, though it is still far behind the PlayStation 2, and its sales in Japan were dismal.

In short, then, the PlayStation 2 has the broadest appeal; the GameCube is aimed at younger gamers and families; and the powerful Xbox has been embraced by hard-core gamers. (Things are not quite this simple, of course, since many popular games are available on two or three of the consoles, and many dedicated gamers own more than one console.) The big question now, as the three firms prepare to launch their next-generation consoles, is how they will position them to maximise their appeal.

Changing the game

This time Microsoft is going first, with a November launch for its new console, the Xbox 360. Its aim is to establish an early lead, just as Sony did with the PlayStation 2 last time around. Microsoft has also made an enormous effort to bring Japanese games-publishers on board, to counter the home-field advantage enjoyed by its two Japanese rivals; the Xbox 360 will have 45 Japanese titles by the end of the year. Microsoft has also made some innovative marketing moves. It unveiled the console on MTV, rather than at a big industry trade show, in an attempt to reach out to consumers directly and steal “mindshare” from its rivals.

In addition, Microsoft has used a trendy technique called “alternate reality gaming” to leak details of its new machine and create buzz on gaming websites. And it has struck a deal with Samsung, so that the consoles will be placed next to high-definition televisions in big stores, where they will be seen by non-gamers. (The next-generation consoles are expected to prompt a flurry of interest in high-definition televisions, for which other content is currently lacking.) Overall, so radical is Microsoft's change of positioning compared with the original Xbox, which was aimed at hard-core gamers, that the new machine really ought to be called the Xbox 180, jokes Ross Rubin of NPD Group, a market-research firm.

For its part, Sony is emphasising the raw power of its new console, the PlayStation 3, which is based around a new chip, called Cell, and a high-capacity Blu-ray optical drive. This will give it substantially greater processing power and storage capacity than the Xbox 360, but both technologies are new and unproven, and it is not clear that consumers other than hard-core gamers really care about such things. And if technological teething problems delay the PlayStation 3 beyond its planned introduction next spring, Sony could lose a lot of ground to Microsoft.

Nintendo has not been so forthcoming about its new console, the Revolution, which is also due next year, except to say that it will have an unusual new kind of controller and—in addition to new titles—will be able to play Nintendo's entire back-catalogue of games, accessible via the internet. The idea is that these older games will draw in casual gamers who are put off by the complexity of modern titles, says Mr Rubin, though using today's powerful consoles to play classic games “doesn't seem to be an efficient use of resources”. Even so, the success of Nintendo's touch-screen handheld console, the DS, suggests that innovative technology plus relatively simple games is indeed a winning formula.

The next round, then, will pit Microsoft's marketing might against Sony's technological prowess and Nintendo's quirkiness and innovation. What will ultimately determine the outcome, however, is the games. “It comes down to the software titles,” says Mr Rubin. People buy consoles to play particular titles, not because they are impressed by their technical specifications. Most observers expect Microsoft to reduce but not eliminate Sony's lead, so that Sony captures 45% of the market next time around, with Microsoft on 40% and Nintendo on 15%. “It's really Sony's game to lose,” says Mr Jackson. But whatever happens, at least gamers should have fun.

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REPORTS

And now, the war forecast

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Software: Can software really predict the outcome of an armed conflict, just as it can predict the course of the weather?

IN DECEMBER 1990, 35 days before the outbreak of the Gulf war, an unassuming retired colonel appeared before the Armed Services Committee of America's House of Representatives and made a startling prediction. The Pentagon's casualty projections—that 20,000 to 30,000 coalition soldiers would be killed in the first two weeks of combat against the Iraqi army—were, he declared, completely wrong. Casualties would, he said, still be less than 6,000 after a month of hostilities. Military officials had also projected that the war would take at least six months, including several months of fighting on the ground. That estimate was also wide of the mark, said the former colonel. The conflict would last less than two months, with the ground war taking just 10 to 14 days.

Operation Desert Storm began on January 17th with an aerial bombardment. President George Bush senior declared victory 43 days later. Fewer than 1,400 coalition troops had been killed or wounded, and the ground-war phase had lasted five days. The forecaster, a military historian called Trevor Dupuy, had been strikingly accurate. How had he managed to outperform the Pentagon itself in predicting the outcome of the conflict?

His secret weapon was a piece of software called the Tactical Numerical Deterministic Model, or TNDM, designed by the Dupuy Institute, an unusual military think-tank based near Washington, DC. It was the result of collaboration between computer programmers, mathematicians, weapons experts, military historians, retired generals and combat veterans. But was the result a fluke, or

was the TNDM always so accurate?

Bosnia was its next big test. In November 1995, General Wesley Clark asked the Dupuy Institute to project casualty scenarios for NATO's impending peacekeeping mission, Operation Joint Endeavour. The resulting “Bosnia Casualty Estimate Study”, prepared using results from the TNDM, stated that there was a 50% chance that no more than 17 peacekeepers would be killed in the first year. A year later, six had died—and the Dupuy Institute's reputation had been established.

The TNDM's predictive power is due in large part to the mountain of data on which it draws, thought to be the largest historical combat database in the world. The Dupuy Institute's researchers comb military archives worldwide, painstakingly assembling statistics which reveal cause-and-effect relationships, such as the influence of rainfall on the rate of rifle breakdowns during the Battle of the Ardennes, or the percentage of Iraqi soldiers killed in a unit before the survivors in that unit surrendered during the Gulf war.

Analysts then take a real battle or campaign and write equations linking causes (say, appropriateness of uniform camouflage) to effects (sniper kill ratios). These equations are then tested against the historical figures in the database, making it possible to identify relationships between the circumstances of an engagement and its outcome, says Chris Lawrence, the Dupuy Institute's director since its founder's death in 1995.

All of this is akin to working out the physical laws that govern the behaviour of the atmosphere, which can then be used in weather forecasting. But understanding the general behaviour of weather systems is not enough: weather forecasting also depends on detailed meteorological measurements that describe the initial conditions. The same is true of the TNDM. To model a specific conflict, analysts enter a vast number of combat factors, including data on such disparate variables as foliage, muzzle velocities, dimensions of fordable and unfordable rivers, armour resistance, length and vulnerabilities of supply lines, tank positions, reliability of weapons and density of targets. These initial conditions are then fed into the mathematical model, and the result is a three-page report containing predictions of personnel and equipment losses, prisoner-of-war capture rates, and gains and losses of terrain.

What is perhaps even more surprising than the TNDM's predictive accuracy is the fact that it is for sale. The $93,000 purchase price includes instruction classes, a year of technical support and a subscription to the TNDM newsletter, although subsequent updates to the software cost extra. Organisations that have acknowledged buying the software include the defence ministries of Sweden, South Africa, Finland, Switzerland and South Korea, along with the aerospace giant Boeing. Such customers rarely divulge the uses to which they put the software. But Niklas Zetterling, formerly a senior researcher at the Swedish National Defence Research Institute in Stockholm and now an academic at the Swedish War College, says his country uses the software to improve its arsenal. Mr Zetterling toyed with the software's technical variables “to create hypothetical weapons” that could then be proposed to engineers.

Rather than simply buying the TNDM, most clients contract the Dupuy Institute to produce studies that combine the software's predictions with human analysis. American clients have included the Joint Chiefs of Staff, the Army Medical Department, the Department of Defence, the Vietnam Veterans of America Foundation and the Sandia National Laboratories (a government-owned weapons-research centre run by Lockheed Martin). The institute is currently preparing a secret forecast of the duration and intensity of the Iraqi insurgency for the Centre for Army Analysis, a Pentagon agency.

Leader of the pack

The TNDM is not the only war-forecasting system. Many other systems have been developed, primarily by armed forces, government agencies and defence contractors in America, Australia, Britain, France and Germany. Some are glorified spreadsheets, but many are far more complex, including the American Navy's GCAM software, the OneSAF model used by the Army and Marine Corps, the Air Force's BRAWLER system and the Australian Department of Defence's JICM. With all these systems, younger officers tend to have more faith in the technology than their older counterparts. (According to a joke among technophiles, old-school military planners refuse to upgrade from BOGSAT, or “Bunch of Guys Sitting Around a Table”.)

A survey of American war-forecasting systems by the Dupuy Institute found that very few are for sale or hire, and officials in charge of government models are often unwilling to share them with rival agencies. The simple availability of the TNDM has favoured its growth, although technology-transfer laws not surprisingly restrict its sale to certain countries.

Systems with a wide customer base, like the TNDM, are regarded as more credible

Another attraction of the TNDM over rival models is the Dupuy Institute's independence: it has no weapons to sell, is not involved in internecine competition for budgetary funding, and has no political stake in military outcomes. Software developed primarily for, or by, a contractor or a branch of the armed forces often favours certain hardware or strategies, says Manfred Braitinger, head of forecasting software at IABG, a Munich-based firm that is Germany's leading developer of war-forecasting systems. The Air Force and Army models differ widely, for example, in their estimates of how easy it is to shoot down planes. “If you run both models you will see a remarkable difference in attrition rates simulating the same scenario,” Mr Braitinger says. Systems with a wide customer base, like the TNDM, are regarded as more credible, since they do not have such biases.

The TNDM's reliance on real combat data, rather than results from war games or exercises, also gives it an edge. Another forecasting system, TACWAR, was used by America's Joint Chiefs of Staff to plan the overthrow of Saddam Hussein. Like many models, it was largely developed with data from war games. As a result, says Richard Anderson, a tank specialist at the Dupuy Institute, TACWAR and other programs based on “laser tag” exercises tend to “run hot”, or overestimate casualties. Real-bullet data is more reliable, because fear of death makes soldiers more conservative in actual combat than they are in exercises, resulting in fewer losses. The discipline is only just beginning to recognise the “tremendous value of real-world verification”, says Andreas Tolk, an eminent modelling scientist at Virginia's Old Dominion University.

Yet another factor that distinguishes the TNDM from other war-forecasting systems is its unusual ability to take intangible factors into account. During NATO's air campaign above Serbia and Kosovo in 1999, for example, the Serbs built decoy tanks out of wood and tarpaulins and painted *trompe l'oeil* bomb-holes on to bridges. Microwave ovens, modified to operate with their doors open and emit radiation, were used as decoys to attract HARM missiles that home in on the radar emissions of anti-aircraft batteries.

Such cunning is one of the many intangible variables that are taken into account by the TNDM's number-crunching equations. Mr Lawrence says incorporating human factors into equations is controversial: most models favour “harder” numbers such as weapons data. But Robert Alexander, an expert on war simulations at SAIC, an American defence contractor, says these are “almost secondary” to human factors.

The Concepts Evaluation Model (CEM) developed at the Pentagon's Centre for Army Analysis, provides an instructive example. While testing the model, programmers entered historical data from the Battle of the Bulge, the German offensive in 1944 against American forces in Belgium. The CEM predicted heavy German losses in the initial attack, yet German casualties were in fact

light. The probable error? The model overlooked the shock value of launching a surprise attack. Analysts duly recalibrated the CEM—using an early version of the TNDM.

The Dupuy Institute is renowned for its ability to take into account such non-material factors: the effect of air support on morale, fear engendered by attack with unexpected weaponry, courage boosted by adequate field hospitals. The mother of all intangibles, within the TNDM model, is initiative, or the ability of lower-ranking soldiers to improvise on the battlefield. Armies from democratic countries—where people are empowered to make decisions—benefit by giving their soldiers some scope to change tactics in the midst of a firefight. Soldiers fighting for authoritarian regimes may not have the reflexes, or the permission, to seize opportunities when they arise in battle.

Maintaining the accuracy of the TNDM means feeding it with a constant stream of new information. The Dupuy Institute's analysts visit past battlefields to augment their statistical data, follow the arms industry closely and cultivate contacts with government defence procurers. In countries where access to military archives is limited, the Institute surreptitiously pays a handful of clerks to provide photocopies.

The next challenge will be to expand the TNDM's ability to forecast the outcomes of “asymmetric” conflicts, such as the Iraqi insurgency. To this end, the Dupuy Institute is hoping to get its hands on the Vietcong archives, as Vietnam opens up. Insurgencies rarely leave much of a paper trail, but the Vietnamese kept detailed records of their struggle against the French and Americans. The resulting papers provide the world's most extensive documentation of guerrilla fighting. “That's where warfare seems to be heading,” says retired Major General Nicholas Krawciw, who is the president of the Dupuy Institute. And wherever warfare leads, war-forecasting systems must follow.

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REPORTS

The march of the robo-traders

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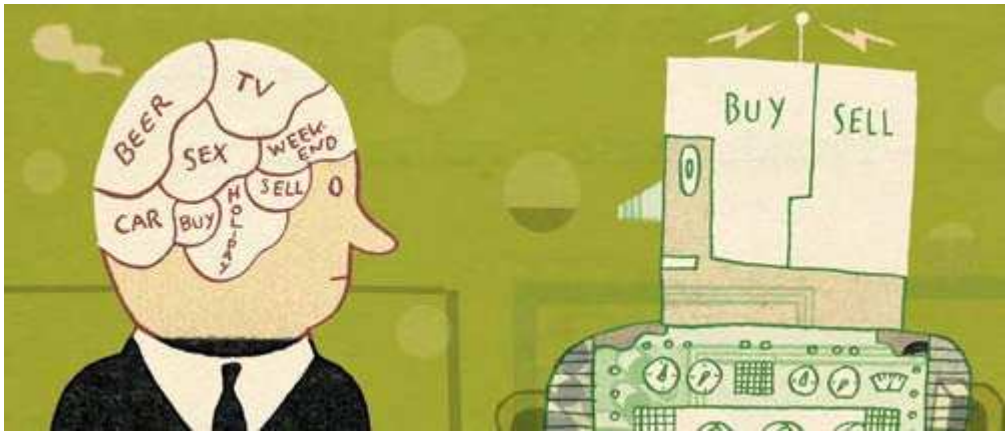

Software: Programs that buy and sell shares are becoming ever more sophisticated. Might they replace human traders?

IMAGINE the software equivalent of a golden goose: a program that continually produces money as its output. It sounds fanciful, but such software exists. Indeed, if you have a pension or endowment policy, or have money invested in share-based funds, the chances are that such a program—variously known as an “autonomous trading agent”, “algorithmic trading” system or simply as a “robo-trader”—has already been used to help your investments grow.

Simple software-based traders have been around for many years, but they are now becoming far more sophisticated, and make trades worth tens of billions of dollars, euros and pounds every day. They are proving so successful that in the equity markets, where they are used to buy and sell shares, they already appear to be outperforming their human counterparts, and it now seems likely that their success will be repeated in foreign-exchange markets too. Proponents of robo-traders claim that, as well as making more money, they can also help to make markets more stable. And, of course, being made of software, they do not demand lunch breaks, holidays or bonuses.

This has prompted an arms race as companies compete to develop the best sets of rules, or algorithms, to govern the behaviour of their robo-traders. “We live and die by how well they perform,” says Richard Balarkas, global head of advanced execution services at Credit Suisse First Boston, an investment bank. The better the technology, the more money it makes for the client, he says.

At the moment, big strategic decisions, such as deciding which shares to buy and sell, are still made by experienced human traders, says David Cliff, who is the director of Deutsche Bank's Complex Risk Group in London and a veteran of the field. Robo-traders are then given the power to decide how to buy or sell shares, always with the aim of hiding their client's intentions. If you are a pension-fund manager and have decided to sell a million shares in some company, merely

revealing your intention to sell will result in the market moving against you, even with very actively traded shares, notes Dr Cliff. So the aim of the game is to try to unload the shares in such a way that no one notices what you are doing.

Buy! Sell! Exterminate!

The simplest algorithmic-trading systems might try to drip-feed the market by slicing up a big trade into a hundred smaller orders. By introducing these trades slowly into the market over some predetermined period of time—a few minutes, or hours, or days—the idea is that the smaller orders are less noticeable, and so have a less dramatic effect on the market price. But such "salami slicers" would not win any prizes these days, says Dr Cliff. Today's more advanced robo-trading programs can cover their tracks more adeptly, for example, by varying the amount they sell, and sometimes even buying back the very stock they are trying to get rid of, he says.

Some firms, such as FlexTrade of Great Neck, New York, now offer complete algorithmic-trading platforms. These allow clients, be they investment banks or hedge funds, to straddle different markets seamlessly and use built-in but customisable trading rules to do their buying and selling. The advantage is that the clients get to use algorithmic trading without all the hassles that come with it, such as having to connect to particular exchanges, check data feeds are live or deal with the sending out of orders that have been placed; the platform does all of those things automatically. But while these kinds of platforms are likely to increase the prevalence of algorithmic trading, those in the business regard them as rather primitive when compared with more sophisticated, proprietary systems.

Robo-traders' main advantage is speed, says Marcus Hooper, a specialist in global electronic-trading solutions for Bear Stearns International in London. In many electronic markets the time delay, or latency, associated with making a trade can be quite significant—in some cases several seconds. This is a major headache for traders. "By the time their fingers hit the keyboard, someone else could have beaten them to it," says Mr Hooper. So any algorithm that can respond faster than human traders has a definite edge, he says.

Another advantage stems from the basic limits that exist on how much information human traders can realistically absorb. Studies have shown that professionals make their trading decisions only after considering three or four variables, says Mr Balarkas. Computers, on the other hand, can take in hundreds of variables simultaneously, and refer back to a wealth of historical data, in the blink of an eye. In 2001 Jeffrey Kephart, a researcher at IBM, compared the performance of human commodity traders with autonomous trading agents. He found that the software agents, which included one developed by Dr Cliff (who at the time was a researcher for Hewlett-Packard in Bristol), produced 7% higher returns than humans.

So is this the end of human traders? Far from it, says Mr Balarkas. Instead, man and machine work best together. "Algorithms are not the financial-market equivalent of an unmanned droid—they need a trader to operate them, just like a Formula 1 car needs a driver," he says. This requires judgment, something computers have yet to master. Algorithmic trading is emerging as an important new tool, but human traders will only use it when appropriate.

"Eventually, robo-traders may be capable of analysing news feeds, deciding which shares to buy and sell, and devising their own strategies."

For instance, although the latest trading algorithms can be pretty sophisticated, a lot of them are based on what are called volume-weighted average-price models. These models set buying or selling prices based on what is calculated to be the average price for a given day—in other words, they use a low-risk, follow-the-herd approach. This has its uses: it can, for

example, be useful to unload a large number of shares far more quickly than might be practical manually.

The human touch

But to make the real money, human traders rely upon riskier strategies that enable them to outdo their competitors. This requires more than just experience, market knowledge and the ability to keep up with the news. And such “alpha-seeking” strategy is extremely underdeveloped in algorithmic trading, says Mr Hooper—not because of any lack of demand for it, but because it is very hard to do. In this regard, human traders still have an edge over heartless robo-trading algorithms. But it is still early days. Algorithmic trading is still in its infancy: it has taken off only in the past four or five years, mainly due to the introduction of the Financial Information Exchange Protocol, which has done for trading what the internet's TCP/IP protocol did for data networking, by allowing different proprietary systems to plug into a common standard.

Some programs do exist that make decisions about which shares to buy and sell. These are used for statistical arbitrage—the practice of monitoring and comparing share prices to identify patterns that can be exploited to make a profit. In the past, software has been used to carry out this sort of analysis and identify, for example, that the best time to buy a particular company's shares is when the spread between its share price and that of a rival firm has reached a certain value. Historically, this information would then be passed on to a human trader to act on. But these days, statistical arbitrage systems are often plugged straight into the market, and can place their own trades.

Might that not be rather risky? Some blamed the 1987 stockmarket crash on computers instructed with simple decision-making rules. These essentially amounted to little more than “if-then” rules of thumb: if a share price drops below a certain threshold, then sell. When a market is falling, this can make a bad situation worse, as low prices prompt more traders to sell, which further depresses prices. Yet despite such worries, the industry has continued to embrace the technology. Indeed, part of the reason for computerising exchanges such as the London Stock Exchange and NASDAQ was to facilitate algorithmic trading, says David Birch, head of research and development at the London Stock Exchange.

Some exchanges now regulate the use of algorithmic trading, both to prevent their systems from being overloaded and to avoid a repeat of the 1987 scenario. On July 7th, for example, the London Stock Exchange asked for algorithmic trading to be suspended after the London bombings. Even though it is impossible for an exchange to tell whether a person or an algorithm is issuing trades, it is possible to monitor the rate of trading to tell whether algorithmic trading is going on, says Mr Birch; human traders cannot issue several trades per second. But a greater dependence on algorithmic trading could eventually make it impractical to order such trading to be suspended, he says.

Mr Balarkas believes the risks are minimal, and that it may not be necessary to switch off algorithmic trading. “By definition, execution algorithms are stealthy and designed to create as little volatility as possible,” he says. And the very fact that they are designed to reduce the market impact of trades should, in fact, have a stabilising effect. No one wants a repeat of 1987, says Dr Cliff, and nobody would knowingly implement an algorithm that they thought might cause a crash. The trouble is, he says, that the secrecy that surrounds these algorithms means that there is no way to evaluate how various trading systems might interact with each other. It is an intractable problem. “But without hideous levels of regulation there is no way round it,” says Dr Cliff.

Beyond worries over market stability, might an even greater danger be lying in wait? Mr Hooper proposes a doomsday scenario. Some day, advances in natural-language processing and statistical analysis might lead to robo-traders capable of analysing news feeds, deciding which shares to buy

and sell, and devising their own strategies. Given that companies are very keen to patent their algorithms, it is quite possible that just one company could then emerge as the victor in this algorithmic arms race, says Mr Hooper. This outcome would create a particularly challenging problem for regulators. “It is a possibility that you could have an unfair advantage—and there would be nothing governments could do about it,” he says.

It is an interesting idea. But it seems unlikely, since there are so many possible trading strategies, and unlike simpler problems in computing (such as sorting a list) it is doubtful that there will turn out to be a single trading algorithm that outperforms all others. Yet perhaps such a suggestion should not come as a surprise. For whenever robots are being discussed—even if they are merely the software-based, share-trading variety—the idea that humans will lose their jobs and the robots will take over the world always seems to be lurking in the background.

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Economist.com PRINT EDITION TECHNOLOGY QUARTERLY

CASE HISTORY

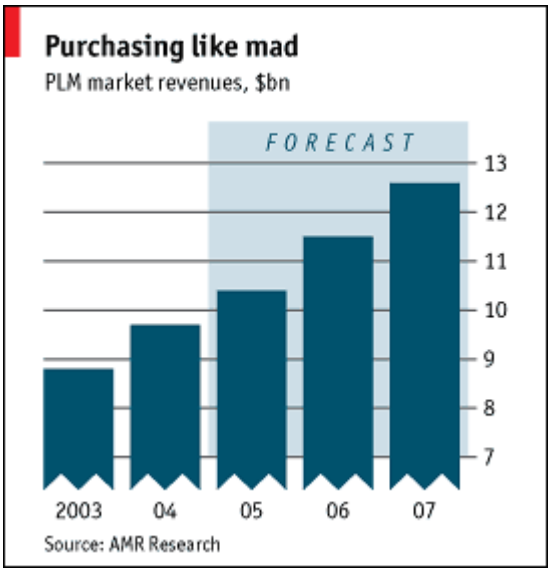
Better by design

Sep 15th 2005
From The Economist print edition

Software: “Product life-cycle management” software that helps companies design, manufacture and manage their products is becoming increasingly popular among big firms

ON DESKTOPS and tables in offices and homes around the world, and on the laps of latte-sippers from Miami to Mumbai, you will find computers made by Dell, the world's biggest PC manufacturer. For a company that shifts tens of millions of boxes each year it is a mammoth task to keep track of all the different components that go into each of its various models, and to ensure that 400 suppliers around the world are kept informed of changes in design or specifications—even as similarly global teams of designers are continuously updating its product line to stay ahead of the competition. Like many other large firms, Dell uses clever software to handle all of these tasks. It is called product life-cycle management (PLM) software, and it is becoming integral to the operation, growth and profitability of many big companies.

As its name suggests, PLM software can manage the entire “life-cycle” of a product, from concept and design to production, marketing and even recycling. Using PLM software, for example, when Dell's engineers design a new computer, they can reuse parts of previous designs, and so keep to a minimum the number of new parts and suppliers. The software also ensures that old and new components fit together perfectly. But according to PLM devotees, there are many other benefits: lower prototyping costs, reduced time-to-market for new products, less waste, improved product quality and faster turnaround of marketing materials.



PLM software, in short, provides the framework within which companies can take new ideas and implement them quickly in actual products. “PLM is becoming the enabling tool for innovation,” says Navi Radjou, a PLM guru at Forrester, a consultancy. As a result, PLM is currently the fastest-growing segment of the business-software market, according to AMR Research, another consultancy. Last year the PLM market was worth $9.65 billion, and grew by 10%; AMR expects 8% growth this year (see chart).

A brief history of PLM

PLM's sudden growth is largely the result of its spread beyond the niches where it first evolved—in the aerospace and automotive industries—into the broader markets of consumer electronics, clothing and packaged goods. In the past, says Walter Donaldson, IBM's general manager for PLM, he would find himself talking to the vice-president of engineering. But these days he is more likely to find himself talking to a company's chief operating officer about how to use PLM to become more competitive. The latest trend, says Mr Radjou, is that large retailers are starting to invest in PLM to manage their private-label goods and compete better with big consumer-goods firms such as Procter & Gamble and Unilever.

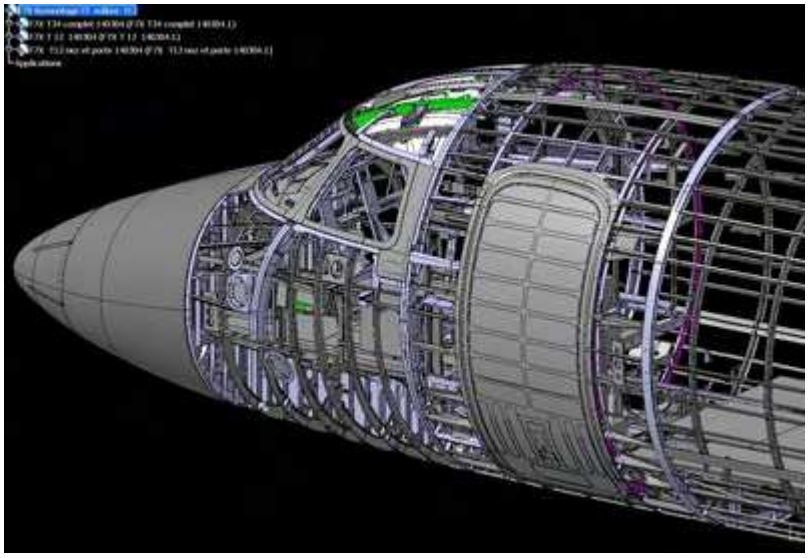
Vendors of PLM software, such as Cadence, UGS, PTC, SAP, Dassault and Agile, generally sell suites of software that do many things, and which have formed by accretion over many years. PLM's origins go back to computer-aided design (CAD) software, a range of computer-based design tools which engineers and architects began using in the 1980s.

In the 1990s, this evolved into product-data management (PDM) software, which features CAD design tools combined with a database of information about components. This makes it possible to work out quickly how much a design change or a new product might cost, among other things.

PDM systems also helpfully centralise product information into a single, authoritative database—sometimes called the “system of record”—thereby doing away with paper plans and reducing the scope for error or misunderstanding. And any changes to a product's plans are quickly visible to the team designing the production line on which it will be built. Nikon's camera division, for example, used to produce around 15,000 design drawings a year that had to be distributed and approved. Using PDM, it has reduced the amount of paperwork by 80%, and drawings can be retrieved five times faster.

Such systems have now been extended so that they are not just for designers and engineers, but also include tools for use by senior managers and marketing people. According to AMR, CAD still accounts for 53% of spending on PLM, but non-CAD spending is growing twice as fast, or 13% a year. The latest PLM systems may include “requirements management” and “portfolio management” tools, so that managers can, for example, look across the range of products in development to make sure they match the demands of the market in question. If they do not, then specifications can be tweaked or products killed off.

PLM systems also allow packaging to be mocked up quickly and then displayed to focus groups via the web, so that the most effective packaging can be identified. In theory, all of this means that the needs of the market can be anticipated and communicated back along the chain to the research and development department. PLM has, then, evolved from humble design tools into elaborate systems that help companies develop and manufacture products that their customers actually want to buy.



The Falcon 7X: PLM eliminated assembly problems

The desire for greater competitiveness and faster response are two reasons why PLM is growing so quickly. But its adoption is being driven by other factors, too. One is globalisation. When firms start to design, manufacture and sell products in many different countries, each with their own requirements and regulations, they face a huge increase in complexity. Heinz uses PLM software to keep track of the different ingredients that go into its ketchups and other products in various countries, to cater to local tastes. By centralising this information, it has been able to optimise its recipes and reduce costs.

For companies that rely on outsourcing or have multiple design and manufacturing centres around the world, PLM can simplify things by allowing people in different countries to communicate and collaborate within a single, secure environment. Rolls Royce, for example, used PLM to facilitate around-the-clock development by engineering teams in Britain, India and America of the Trent 900 engine for the Airbus A380.

Another factor driving PLM is that products themselves are becoming far more complex, which makes it harder to ensure that all the different parts will fit together and work properly. PLM can help to minimise such problems for even the most complex products, such as aircraft.

“PLM software provides the framework within which companies

Dassault Aviation claims that its Falcon 7X corporate jet, launched this

summer, is the first aircraft ever to be designed entirely in a virtual environment. PLM software was used to link Dassault with 27 subcontractors to create a digital model of the aircraft. Everything was meticulously modelled, including the robots that build the tools to fit the aircraft's parts together and the maintenance processes once the aircraft is in service. This eliminated assembly problems, so that the first plane to be constructed was perfect: there was no physical prototype. The parts were manufactured and put together, and the plane took to the air.

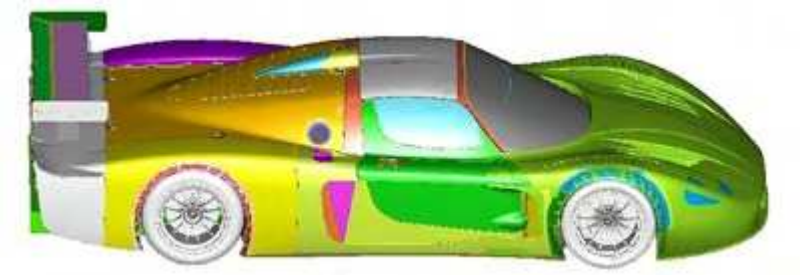
can take new ideas and implement them quickly in actual products."

The need to comply with different regulations provides another reason to adopt PLM. New restrictions on the use of lead, cadmium, chromium and other materials in electronic equipment will come into force in Europe in 2006. So companies need to be able to track what is going into their products. PLM systems can produce a bill of materials for each product, making it easier for a firm to check that its products comply with local regulations.

Regulation has also prompted the adoption of PLM in package design. Pharmaceutical companies that frequently repackage their products, but must comply with strict regulations that vary from country to country, can use PLM to track design changes and make sure that each package conforms with the local regulations. Once the software is in place, people in the legal, medical and design departments can look at the design in parallel and approve it—rather than waiting for paper documents to circulate. Chris Farinacci of Agile says that 50-60% of pharmaceutical product-recalls are to do with packaging problems.

A poster child for PLM

Some firms, of course, face many of these challenges at the same time. A good example is General Motors. Speaking at a recent conference in London, Diane Jurgens, a PLM guru at GM, said the company regards PLM as crucial to its survival. Her job title is, rather improbably, "director of global product development process and systems integration and information systems and services". But her job is essentially to make the world's biggest carmaker more efficient.



From its origins in the aerospace and automotive industries, PLM is now moving into consumer goods...

GM employs 325,000 people, has 19 design centres around the globe, and builds cars in 32 countries. To add to the complexity, ithas different brands in different regions, such as Holden in Australia and Opel in Germany. It must balance the desire to centralise where possible with the need to localise where necessary: American buyers expect a "new car smell", for example, but Asians do not.

...such as cameras...

In 1997, GM was taking an average of 48 months to develop each new vehicle, compared with 36

months at Toyota, one of its biggest competitors. GM was big and unwieldy, and had competing teams of designers, says Ms Jurgens. So in 2000 the company decided to sort out the mess, and bought a PLM system from UGS. Today, 10% of GM's employees use it. Parts and whole subsystems from one vehicle can now be easily reused in another. Changes to a vehicle's design can be immediately reflected in the design of the dies that stamp out the doors and body panels. And new models can be crash-tested thousands of times in virtual reality. GM also uses PLM to collaborate with its suppliers. This makes it possible for everyone to see what a part should look like and where it fits into the overall design, to ensure that it fits perfectly. But perhaps the best illustration of the success of GM's PLM initiative is that the development time for new vehicles is now just 12-18 months.

The trickle-down theory

...and razors

GM's experience also highlights some of the challenges involved in adopting PLM. By its very nature, it changes the way that people work and interact. Industrial designers, for example, may find themselves having to work very closely with engineers—having previously been separated by incompatible file formats. The research & development department may not be accustomed to dealing with the marketing department. And old habits die hard. Many GM staff did not ordinarily share their files and data, says Ms Jurgens. And designers, in particular, were reluctant to switch to the new PLM-friendly design software.

Where next for PLM? The next step, says Mr Donaldson of IBM, will be to broaden access to the technology and bring medium-sized companies, not just engineering and consumer giants, into the world of PLM. It is shaking off its engineering origins and is moving, he says, into the mainstream parts of business. IBM is currently working to help business and engineering schools better understand the technology. Clearly, if lots of newly minted business graduates have been taught about PLM, they are more likely to want to use it when they get jobs.

Mr Radjou notes that the trend towards outsourcing is already forcing medium-sized companies to adopt PLM in order to service their larger customers. PLM is a collaborative tool, and the more that working practices such as design and manufacturing are broken down into modules, the more scope there is for even smaller companies to plug into bigger firms'PLM networks. “But the vendors are not really providing anything for them yet,” says Mr Radjou, “which is why Microsoft is getting into the space.” At the same time, other technology vendors such as IBM and SAP are also starting to incorporate PLM features into their other business software.

This is a testament to PLM's success, but paradoxically could cause it to disappear. “I'm not sure PLM will survive as a stand-alone category,” says Mr Radjou. Instead, he says, PLM functions will be broken down and bundled into other applications, such as supply-chain management systems and even desktop productivity software. Oracle, the world's second-largest software company, will probably buy one of the PLM vendors and incorporate its software into its general business suite, Mr Radjou predicts. Microsoft is working to add collaboration and document-sharing features to its Office suite. So PLM could become almost as ubiquitous as PowerPoint presentations or Word documents—but by then it will almost certainly be called something other than “product life-cycle management”. It is the hallmark of a successful technology that it becomes almost invisible. And so the final, triumphant stage in the gradual ascent of PLM could be that it disappears altogether.

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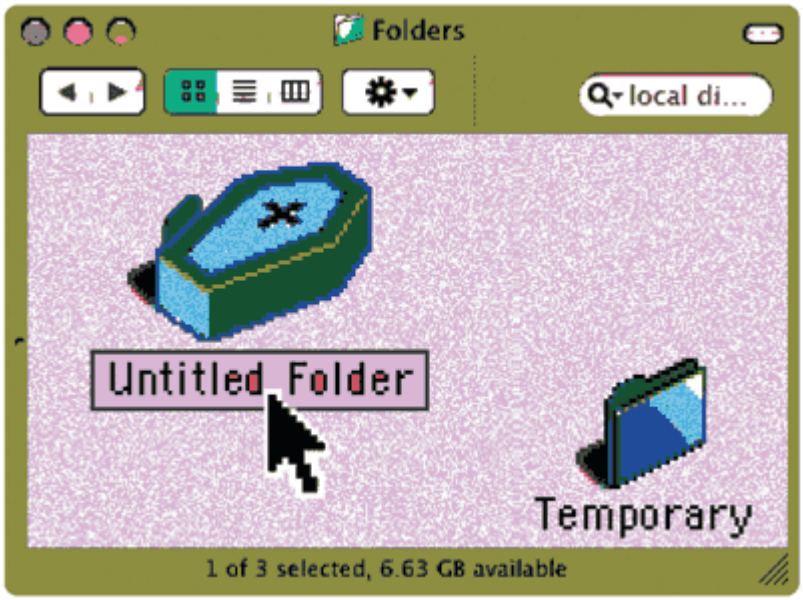
REPORTS

Death to folders!

Sep 15th 2005
From The Economist print edition



Computing: Cheap hard disks and fast search software could change the way we store and find documents on our computers

ANYONE who uses a personal computer will be familiar with the idea of a “graphical user interface”, which was introduced in the 1980s and became ubiquitous in the 1990s. It did away with the need to type cryptic keyboard commands to manipulate files, making it possible to manipulate them directly instead, using a mouse: double-click on a file's icon to open it, drag it to the bin to delete it, and drop it on a folder to file it away.

All of this made computers far easier to use. But the once-revolutionary notion of files, folders, filing cabinets and other desktop icons is now showing its age. What started out as a helpful metaphor now seems rather limiting. Why hobble digital documents with the limitations of paper ones, such as the need to have a single fixed location? “A lawyer cares about things like dates and cases,” says Thomas Rizzo, the head of Microsoft's next-generation file system project, known as WinFS. How can a lawyer file the same document by both client and by date? He cannot, notes Mr Rizzo, without using unwieldy multiple-location workarounds such as aliases and shortcuts.

Another problem, as personal computers start to fill up with thousands of photographs, music tracks, saved web pages and other documents, is that the file-and-folder metaphor requires users to decide upon a logical filing system, and then stick to it, if they want to be able to find things easily. The only thing worse than creating such a nested hierarchy of folders, or directories, is not creating it. Folders thus saddle computer users with the menial task of keeping the filing system neat and tidy, notes Philip Schiller, Apple's senior vice-president of marketing. “You're the janitor,” he says. But most computer users could not care less about folders, a way of organising digital

files that is a relic from computing history.

To further complicate matters, data on personal computers is being Balkanised as different pieces of software circumvent the creaking file-and-folder approach and establish their own structures for organising particular kinds of data. E-mail programs were early examples of this trend: most of them maintain what is, in effect, a database of e-mail, hidden away in its own folder and often inaccessible to other programs. Contact-management, calendar and photo-album programs now do the same. To find all the information relating to a personal contact, you may need to search within a contact-management program, a calendar, an e-mail program and the computer's file system—though filenames do not always contain enough information to connect them to a particular person or project.

Oddly, however, just as it is becoming harder to find things on your computer, it is becoming much easier to find things on the web. Search engines such as Google can search billions of pages in a fraction of a second: if you have a broadband connection, it is usually quicker to look up the phone number of a restaurant via Google than to boot up your address-book software. The desktop-computing metaphor, and the notion of folders in particular, has fallen behind. It is time to shed this relic of the past. It is time for folders to die with dignity—and to yield to a new, more web-like way of storing and finding things.

Never delete

This new approach to organising data is being brought into being by the convergence of two trends: the plunging cost of hard-disk storage and the growing reach of search software. Have you emptied the rubbish bin on your desktop lately? Probably not—unless you edit a lot of music or video, the chances are that you have far more disk space than you need. A typical hard disk on even a cheap computer today holds 40 to 80 gigabytes of information, which is enough for millions of e-mails, tens of thousands of photos, and hours of video. By 2009, a typical PC will have a 160-gigabyte hard disk, and the biggest disk drives will have a capacity of 1,000 gigabytes, or one terabyte, says Dave Reinsel, director of storage research at IDC, market-research firm. Today, he says, most users' hard disks are about 30% full. When storage space is so abundant, why throw anything away?

As storage capacity has grown, however, the ability to search such large piles of data has not kept pace. Until recently, most operating systems, including Microsoft Windows, Apple's Mac OS X and the various versions of Unix had the same search functions they had ten years ago. Only now are they being revamped. Even today, Windows and, until this year, Mac OS X performed the most primitive form of searching by matching a query against filenames one at a time. Searching in this way is akin to looking for a library book by examining every book on every shelf, one at a time. Libraries, of course, have catalogues to make it easier to find books. And now the same idea is being grafted on to computer file systems. The first implementation appeared in Mac OS X, but Microsoft and Google are close behind.

In theory, speeding up search is easy: all you have to do is build a database, akin to a library catalogue, that has an entry for each file, along with information about its content. But for this database to be useful, it must be constantly updated. Every time a file is altered, its corresponding entry in the database, and the various indexes that refer to it, must be updated too. This involves meddling with the computer's operating system at a fundamental level, and has historically been difficult to achieve without a dramatic reduction in the computer's performance.

“As the power of desktop-search software grows, the need to organise things in folders disappears.”

Apple finally solved this problem this year when it released Mac OS X 10.4, known as Tiger. Every time a file is changed, it is added to a queue for re-indexing by Tiger's built-in search engine, called Spotlight. The re-indexing then occurs when the computer is relatively idle, which ensures that maintaining the file database does not overpower the system. The result is that documents scattered across the hard disk can be summoned with Google-like speed and simplicity.

Microsoft is doing something similar through its even more ambitious (but much delayed) WinFS project. The aim is to build an advanced database, using elements of Microsoft's SQL Server, into the Windows filing system to enable access to files with the speed and complexity of a database query. “We are fundamentally changing the way you store your data inside your file system,” says Mr Rizzo. Project-management software could, for example, call up all files relating to a particular project, or a jukebox program could ask WinFS to retrieve all files of type “music”. But although WinFS was originally intended to be part of Microsoft's forthcoming Windows Vista operating system, formerly known as Longhorn, it was dropped as an integral element when development fell behind schedule. Vista is expected in late 2006, but WinFS will not be released until 2007.

In the interim, both Microsoft and Google have launched Windows-based desktop-search products that lack the deep and elegant integration of Spotlight or WinFS, but do similar things. Microsoft's Windows Desktop Search and Google's Desktop Search are separate, free software packages that must be installed on the desktop, though Microsoft's product will be incorporated into Windows Vista next year. Like Spotlight, both have a variety of plug-ins that let them index common file types, such as Microsoft Office documents and messages inside popular e-mail programs.

By doing away with the main drawback of traditional file-searching—that it cannot see inside the files, only their names—Apple, Google and Microsoft are hammering nails into the coffin of the old file-and-folder approach. As the reach and power of desktop-search software grows, the need to put things in organised folders disappears. With Spotlight, “I just search for everything now—I spend almost no time browsing through folders,” says Steven Johnson, author of “Interface Culture”, a book about computer interfaces.

Let's play tag

That said, search engines cannot reach inside every kind of file: they cannot yet distinguish photographs of one person from another, for example. Many kinds of file, however, incorporate helpful “tags” that describe their contents. Digital cameras attach tags to photographs to record information about the time, date and exposure details; MP3 audio files generally contain tags listing the track name, artist, and other information. “We believe that data is becoming more and more structured. That's good for being able to find things and relate things together,” says Mr Rizzo. Increasingly, users will start to attach tags of their own to files, too.

When saving a document five years from now, rather than naming it and dropping it into a folder, you may well tag it with a few keywords and drop it into a database. “You can just tag it instead of filing it, and you can rely on the search system to quickly find all the things with the same tag,” says Marti Hearst, a computer scientist at the University of California at Berkeley's School of Information Management & Systems. Her tag-based retrieval system, called Flamenco, can be seen online.

Ironically, the search-based metaphor also allows folders to be reincarnated in a new and more useful form. Spotlight has a “Smart Folder” feature that looks like a folder, but is in fact the result of a search. So you could, for example, create a Smart Folder that contains all files, e-mails and other documents mentioning “sausages” that were modified in the last month: the search software then populates the folder with anything that matches these search criteria, and keeps the contents constantly updated. (The name implies that if these are Smart Folders, then existing folders must be stupid ones.)

The idea of establishing relationships between pieces of information, to allow connections to be made and results to be retrieved, is not new. Vannevar Bush, in his famously prognostic and influential essay in the *Atlantic Monthly* in July 1945, described how adding structured code words to associated microfilm pages in his imaginary “Memex” information-retrieval system would help researchers. “It is exactly as though the physical items had been gathered together from widely separated sources and bound together to form a new book. It is more than this, for any item can be joined into numerous trails,” Bush wrote.

Flamenco, WinFS and Smart Folders allow items that meet particular criteria to appear many times in the same hierarchy, and to move around as their contents or attributes change. Traditional folder hierarchies, in contrast, are rigid structures resistant to updates and multiple views.

Looking further ahead, the combination of databases, tagging and search will make it possible to navigate large numbers of documents in all kinds of radically new ways. David Gelernter, a computer scientist at Yale University, imagines searching using time and space axes: imagine picking New Haven, Connecticut, on a map and then zooming back to 1701 to see information about its founding. Ben Shneiderman of the University of Maryland has devised a new way to display search results in which data appear as concentrations of information in a “tree-map”: the colour, position and size of thousands of results can then be taken in at a glance. As folders fade away and search software evolves, it seems that we may, at last, be able to find what we're looking for when we need it. With the death of the folder, perhaps we can finally get some work done.

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REPORTS

Just what the patient ordered

Sep 15th 2005
From The Economist print edition

Medicine: Patient-driven approaches to developing drugs for orphan diseases are turning pill-takers into pillmakers

IN THE face of mortal illness, patience is not necessarily a virtue. When Kathy Giusti was diagnosed with multiple myeloma, a form of cancer, doctors gave her just a few years to live. Like many patients, Ms Giusti took to the internet to learn as much as she could about her illness. But that meant precious little when it came to treatments for her disease. At the time of her diagnosis, in 1996, there were no exciting new drugs in development for multiple myeloma; in fact, there were no new drugs at all. “The medicines they recommended for me were the ones they used on my grandfather, years before,” says Ms Giusti.

With only 50,000 sufferers in America, multiple myeloma is one of thousands of “orphan” diseases that are simply not common enough to interest most drugmakers: there are too few sufferers to justify the cost of developing a new treatment. Although special legislation exists in Europe and America to encourage drugmakers to tackle orphan conditions, the combination of tax breaks and market exclusivity on offer are simply not enough for many firms to attract them to the field. So Ms Giusti, a former pharmaceutical executive, set out to do something about it—and she has succeeded. In 1998, she and her twin sister founded the Multiple Myeloma Research Foundation (MMRF) with the aim of raising money and awareness to “jumpstart” researchers' bright ideas into treatments. Just a few years later, MMRF has garnered more than $50m for research, there are now roughly 110 drugs in various stages of development for the disease, and Ms Giusti has proven her doctors' prognosis wrong.

The idea of charities or patient advocacy and support groups funding drug development is nothing new. In the 1950s, for example, the National Foundation for Infantile Paralysis and its “March of Dimes” bankrolled the development of a polio vaccine. But today's patients' groups are more intimately involved in the nitty-gritty of drug creation, creating their own clinical-trials networks, establishing tissue banks and even setting up their own biotech companies.

So why are today's patients getting more involved in drug development? Frustration at the slow pace of research is one reason, according to Bob Beall, head of the Cystic Fibrosis Foundation (CFF). When the gene for cystic fibrosis was discovered, patients expected this knowledge to be converted relatively quickly into therapies. When commercial interest was slow to materialise, patients realised they would need to play a more active part, says Mr Beall. This patient power stems from a general medical trend, particularly noticeable in America, where “health-care consumers” are encouraged to take greater responsibility for their own well-being; seven years of direct-to-consumer advertising of prescription drugs, bombarding television screens across America with commercials for the latest, greatest pills, have also raised both awareness and demand.

At the same time, says May Liang, head of the Epilepsy Therapy Development Project, “venture philanthropists”—entrepreneurs who bring the same rigorous thinking and streamlined decision-making to not-for-profit foundations as they apply in their normal business lives—are transforming the field. Their business savvy allows patient groups to speak the same language as the companies with which they need to deal. Ms Liang's own foundation, for example, was created by three men with backgrounds in business and banking, whose young children developed epilepsy, and who came together to stimulate interest in drug development.

“Patients are getting involved in drug research and trials, and are even setting up biotech firms.”

CFF is another prominent player. Since 2000, the group has spent almost $240m on research into this fatal inherited disease. As well as financing academic scientists, the foundation also provides venture capital to biotech firms that are willing to take on the tricky task of finding a drug to treat the underlying genetic defect of the disease, not just treat its symptoms. The group has venture deals, which feature all the regular commercial terms of milestones and royalties, with a number of biotech companies, including Vertex. The first drug emerging from that partnership could enter clinical trials within the next couple of years. This sort of money is particularly welcome to small biotech firms which are finding it hard to secure early-stage financing from increasingly wary investors. The idea, says Mr Beall, is to take much of the risk of drug discovery and development off the shoulders of companies, in the hope of enticing them into the area.

But such foundations are worth more than money alone. MMRF, for example, has managed to instigate and co-ordinate valuable research collaborations. Such initiatives start with information. The foundation has compiled a web-accessible database of 110,000 people with an interest in multiple myeloma, from researchers and clinicians to patients and even financial analysts covering the biotech industry. MMRF also keeps track of all clinical trials on multiple myeloma, so it has a clear view of exactly what is happening in the field.

The power of information

It then turns this information into action. MMRF has put together a consortium of medical centres in America and Canada which can undertake clinical trials, with common protocols for everything from patient recruitment to patent rights. The consortium is working with Chiron, a biotech firm, on an early-stage trial of a new anti-cancer drug, with several new centres and compounds expected to enter the network over the coming months. MMRF's power comes not just from its

dollars but from its constituents. As a patient-based organisation, it can tap directly into one of the scarcest commodities in drug development—access to the right patients for clinical trials.

This connection to patients and research centres is vital for small biotech firms, says Julian Adams, chief scientific officer of Infinity Pharmaceuticals, a cancer company. “We are not like big pharma. We are not the 800lb gorilla who can just put money on the table and buy our way into the clinic.” The medical consortium is intimately involved with the companies that tap into its networks, tracking their progress in monthly conference calls and offering tiny firms help with paperwork and other practical points that might otherwise hinder their efforts.

MMRF also brings together representatives from America's drug regulator, the Food and Drug Administration, with experts from academia and industry to tackle bottlenecks in drug development. Dr Adams is impressed by the group's convening power. When he was working at Millennium Pharmaceuticals and leading the development of Velcade, a breakthrough drug for myeloma, he attended a meeting held by MMRF which assembled the leading researchers and clinicians in the field. After presenting some early clinical data, “instead of the usual rubber-chicken dinner, I asked Kathy Giusti if we could design the trial,” says Dr Adams. With all the experts in one room, they worked out exactly how the trial should be run; it began only three months later—lightning speed for the industry.

Other groups are also pitching into drug discovery and development. Genetic Alliance, a network of more than 600 support groups representing patients with inherited disorders, is trying to set up a database of information about the diseases in question for researchers to consult. Not only does this provide one-stop shopping for scientists, but also provides them with information they might not easily find elsewhere, such as negative trial results. Like MMRF, the alliance has also established a biobank so that its constituent groups can deposit tissue samples and clinical data, using standardised consent forms, material transfer agreements and other paperwork—a potential treasure trove for researchers interested in testing drugs for these conditions.

The ALS Therapy Development Foundation (ALSTDF) has gone even further, hiring scientists and setting up its own laboratory to look at hundreds of existing compounds for their potential to treat amyotrophic lateral sclerosis, a fatal neurodegenerative disease. The benchmark for success is straightforward, says James Heywood, its director, whose brother Stephen was diagnosed with ALS seven years ago: “What piece of information would convince me to put Stephen on the drug?”

So far, progress has been slow. On a budget of $4m a year, the group has funded clinical trials at the University of California, San Francisco of two drugs, currently used to treat sickle cell anaemia and HIV, which showed modest activity against ALS. (In a strange twist of fate, the neurologist who designed the trial, Rick Olney, has developed ALS and is now participating as one of its patients.) ALSTDF has also spun off a biotech company, called Alsgen, to develop some of the ideas emerging from its earlier work.

“I've learned a couple of things that are a little disappointing,” admits Mr Heywood. “I thought initially that there were all these good ideas that just needed a push; it turned out that there weren't a lot of great ideas.” The problem, says Mr Heywood, is that much of the pre-clinical evidence on which people were willing to take drugs to trial turned out, on further investigation, to be wrong. The foundation now hopes to strengthen these scientific foundations by trying to establish a valid biomarker—a biochemical or biological feature that correlates with disease and can therefore be used as a surrogate measure of drug efficacy or safety—for developers to use in their efforts on ALS.

For many other patient groups, however, the trouble is not too few drugs on the horizon, but rather too many. As Ms Giusti points out, only 25% of the drugs in development for multiple myeloma are probably worth pursuing: the key is to choose the most promising candidates, and

focus precious money and manpower—especially scarce patients for clinical trials—on them.

Another challenge lies in co-ordinating the patient groups themselves, so that those working on, say, myeloma or ALS, are not duplicating, or worse, competing with, each other's efforts. Above all, there is the tricky business of explaining to patients, whose donations largely fund the efforts of groups such as CFF and MMRF, that most drugmaking will end in failure. That, after all, is why the big drug companies are unwilling to invest: the reward does not justify the financial risk. Patients' groups, of course, quantify risks and rewards using an entirely different yardstick. “The biggest risk”, says Mr Beall, “is if we hadn't made this investment at all.”

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Economist.com PRINT EDITION TECHNOLOGY QUARTERLY

BRAIN SCAN

Medicine without frontiers

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From The Economist print edition

Leroy Hood, one of medicine's boldest visionaries, has spent his career marrying biology with technology

TEN years from now, you will not have to spend hours in a doctor's office to complete a comprehensive health check-up. Instead, with just a single pin-prick, a nanotechnology device will quickly measure and analyse 1,000 proteins in a droplet of your blood. Based on this “molecular fingerprint”, your doctor will prescribe drug regimens tailored to your personal state of health that will not only be able to reverse many diseases, but will also prevent their manifestation in the first place.

That, at least, is how Leroy Hood, the president and co-founder of the Institute for Systems Biology, a non-profit organisation based in Seattle, lays out the future of medicine. “The Human Genome Project has given us a parts list,” he explains. The next step is to capture the information from all the elements in a biological system: DNA, proteins, cells and organs, and then create new mathematical models that will represent the relationships between them. The ensuing digitisation of biology, he reckons, will revolutionise the entire health-care system and usher in a new era of predictive, preventive and personalised medicine.

Today, it sounds far-fetched. But as many of his colleagues and friends attest, Dr Hood, an avid outdoorsman, has never been shy of climbing a mountain or going out on a limb. Throughout his career, the 66-year-old has made it a habit to champion ideas that were initially unpopular but later proved correct. For one thing, he was one of the early proponents of the project to sequence the human genome, at a time when many of his contemporaries had doubts about its viability. Moreover, the very instrument that turned the endeavour into a success, the automated DNA sequencer, originated in his laboratory.

Yet the machine for which he is best known is only one of many inventions Dr Hood has successfully commercialised. To date, he has co-founded more than ten companies, including Applied Biosystems, which went on to become the biggest life-science instrument company in the world, and Amgen, the largest biotechnology firm in the world. He also holds 14 patents, has won numerous awards, and has co-written four textbooks—with a fifth, about systems biology, now in the works. But, most important, he has become one of medicine's boldest visionaries.

Even at a young age, Leroy Hood showed an independent streak. Growing up with his family in rural Montana, he developed an early affinity for the outdoors and started hiking in the nearby mountains as a young boy. While he excelled in the sciences, he was never a nerd. He learned to play the piano, among other instruments, joined a successful debating club and, during high school, was quarterback in an American football team that was undefeated for more than three

years.

He finally set his sights on biology when his high-school chemistry teacher asked him to help teach a class on the subject for younger students. He agreed on the condition that he could base his lectures on articles from *Scientific American*, a popular science magazine. One article from 1956, about the structure of DNA, made a lasting impression on him. The same chemistry teacher also pushed the young Hood to apply to the California Institute of Technology, where he would spend much of his student and professional life.

Immune response

As a PhD student at Caltech in the mid-1960s, Dr Hood got his first taste of scientific controversy, when he became involved in an argument over how the human immune system produces such a wide diversity of antibodies to fend off disease. Up until then, the explanation for antibody diversity had been based on the theory that one gene provides the recipe for one protein, or polypeptide chain. (An antibody consists of four such chains, in two identical pairs.) But when it became apparent that the human genome contained at most 100,000 genes, while the body could create hundreds of millions and possibly billions of antibodies, that explanation was thrown into question.

Together with his mentor, William Dreyer, Dr Hood proposed a radical new hypothesis. They suggested that antibodies were encoded by a relatively small number of genes that can rearrange themselves to make up new sequences, akin to creating new sentences by breaking up and reshuffling a string of words.

The suggestion that some genes might not have a permanent structure, but could splice and rearrange themselves, seemed outrageous at the time, and it catapulted Dr Hood into the midst of a cutting-edge discussion in immunology. As a result of all the hoopla, and despite being only a graduate student, he was invited to travel and give lectures at prominent universities and national meetings (though he also spent hours in the laboratory sequencing proteins by hand). In the end, it took another ten years until all the tools became available to prove the theory right, which led to a 1987 Lasker prize for Dr Hood, Philip Leder and Susumu Tonegawa (who also received the Nobel prize later that same year).

Frustrated by the limitations of manual laboratory work, Dr Hood concluded that it was essential to invent new tools that could drive biological discovery. So when Caltech hired him in 1970 as an assistant professor, he decided to divide his time between technology and biology. By the end of the decade, his efforts had born fruit—his laboratory created a new protein sequencer that was much more sensitive than previous instruments. And when a friend suggested mass-producing the device, Dr Hood went knocking on doors.

Finding a sponsor was easier said than done. After 19 rejections, Dr Hood was somewhat discouraged. Fortunately, a venture capitalist heard about the prototype and offered him $2m to start a company. Dr Hood was elated, but his difficulties were still not over. Today, eager universities help professors to file patents and commercialise ideas. But back then it was uncommon for academic institutions to be so co-operative. Caltech's president at the time, Marvin Goldberger, was reluctant to make commercial deals, although he finally relented and gave the go-ahead for the creation of Applied Biosystems.

The company's success was based on four machines, all of which originated in Dr Hood's laboratory during the 1980s. (As a result, Caltech still receives patent royalties of approximately $10m a year.) Together, they opened up new fields in biology. The protein sequencer, for

“Critics suggest that systems biology may

example, made possible the analysis of small amounts of protein that had previously been inaccessible. Next, the protein synthesiser assembled long chains of amino acids, making it possible to produce large quantities of proteins. The third machine, the DNA synthesiser, could churn out pieces of genes to aid in DNA mapping and cloning. But the most sophisticated instrument was the automated DNA sequencer. It replaced confusing radioactive labels with laser-activated fluorescent dyes, making sequencing faster and much more precise.

simply be too complex for mathematics. Dr Hood is unfazed."

Back in 1985, however, when Dr Hood participated in the first meeting to discuss the possibility of sequencing the human genome, biology was still very much a manual science. People worked with Petri dishes and cultures of goo, explains Michael Hunkapiller, a former research fellow in Dr Hood's lab who went on to become president of Applied Biosystems, and is now a venture capitalist. "The molecules that affected biology were viewed at that time as too complex to analyse easily," he says.

As a result, many biologists were wary of the project. They worried that the technology was not up to the job, that it would take too much time and cost a fortune, thus drawing away valuable resources from other research. Others were repelled by the idea of "big science", fearing that the sociology of the field might change to one that would be dominated by expensive, large-scale enterprises.

Biology without borders

In the end, the project—which finished in 2003, ahead of schedule and under budget—fundamentally changed how biology is practised. According to David Baltimore, the current president of Caltech, it highlighted the need to involve scientists from fields outside biology, leading many universities to adopt cross-disciplinary approaches to the subject. This approach is, of course, vintage Leroy Hood, observes Roger Perlmutter, executive vice-president of research and development at Amgen, and who also heads the board of the Institute for Systems Biology. "Since he joined Caltech as a faculty member, he has been trying to marry engineering and the physical sciences with biology in order to produce tools that could revolutionise biomedical research," he says.

Over the years, as the ambition of Dr Hood's plans grew, so did his staff. When he first arrived at Caltech in 1970 he had fewer than ten people associated with his lab. By 1990, there were more than 100. Dr Hood then became interested in creating an entirely new department, explicitly dedicated to cross-disciplinary efforts and comprised of biologists, chemists and engineers. But such a grand vision for the relatively small school did not sit well with the rest of the faculty. In the end, the majority of biologists reacted negatively to the idea.

In 1992, Dr Hood was invited to chair the new cross-disciplinary Department of Molecular Biotechnology at the University of Washington in Seattle. With $12m in start-up funds from Bill Gates, he accepted. "But the seeds of tragedy were sown for the next thing," says Dr Hood, even though he achieved a lot over the following years. Among other activities, his department operated two of the 16 centres for sequencing the human genome, and one of its members helped create the field of proteomics, the cataloguing of the proteins for which the genome provides the recipes. But in the end he was unable to convince the dean of the medical school to allocate more space for his once-again growing department.

Experiences like this convinced Dr Hood that it is virtually impossible to develop revolutionary new ideas within existing structures. So in 2000, at the age of 61, he decided to leave academia behind. Together with two former colleagues, he formed the Institute for Systems Biology—

without a penny of endowment.

Already, the institute has more than 170 staff members and an annual operating budget of $28m, mostly from government contracts and grants. Moreover, Dr Hood has been able to attract an amazing calibre of collaborators, including Michael Phelps, the inventor of positron-emission tomography, who chairs UCLA's Department of Molecular and Medical Pharmacology, and James Heath, a physical chemist at Caltech who belonged to Richard Smalley's group that discovered “buckyballs” (soccer-ball shaped carbon molecules). Together they have founded the NanoSystems Biology Alliance, with the aim of developing a nanosensor device capable of making five measurements from a blood sample by the end of this year, and 1,000 or more within ten years. “These nanotechnology tools will be mass-produced and used by every scientific investigator, even in small labs,” predicts Dr Hood.

Despite his track record, his new ideas have proved as controversial as ever. Critics point out that systems biology may simply be too complex for mathematics; others say the timetable for creating the proposed nanotech instruments is too ambitious. But Dr Hood, who has heard similar arguments before, is unfazed by the scepticism. “It doesn't bother me in the slightest,” he says. “In the end what counts is what you do.”

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America's airlines

Flying on empty

Sep 15th 2005
From The Economist print edition

Bankruptcy is becoming normal for America's airlines

Get article background

OVER the past four years, America's airlines have lost $32 billion, hit by the effects of terrorist attacks, the collapse of the dotcom bubble, the war in Iraq, the SARS epidemic in Asia and fiercer competition from new low-cost carriers. This devastated landscape is now being visited by a sixth horseman of the apocalypse: oil prices. On September 14th Delta Air Lines and Northwest Airlines, America's third and fourth-largest airlines, filed for bankruptcy. With United and US Airways already operating under Chapter 11 bankruptcy regulations, at least half of America's airline industry has now been declared bankrupt. These firms will keep flying on empty, thanks to court protection from their creditors. But a once-proud industry is officially on its knees.

The impact of higher oil prices on the industry was outlined this week by Giovanni Bisignani, the director-general of the International Air Transport Association. He forecast that this year American carriers' losses would be around $8 billion, some $2 billion more than he had forecast as recently as May, when the price of oil, at $47 a barrel, was already twice that of four years ago. Today the oil price stands at $64. Facing fierce competition from relative newcomers like Southwest and JetBlue, which are still profitable, the older, “legacy” airlines, with their much bigger fixed-costs, are unable simply to pass the higher oil prices onto their customers.

Yet earlier this summer there were some signs of light in the skies. Airline passenger numbers were up. Planes were on average 79% full, which was a small improvement. Revenues per seat

(“yields”) were still falling (1.8% down on the same period in 2004), but that is part of a long-term trend. Thanks to fierce cost-cutting, and with the co-operation of worried unions, there were flickers of hope on the horizon. In the April-June quarter, American Airlines, the biggest, made $58m, its first net profit (excluding special factors) in five years. Continental Airlines did even better, with revenues up 12% and a net profit of $100m. Even United Airlines, stripping out huge exceptional charges related to its plans to emerge from bankruptcy, reduced its quarterly loss to $26m, from $247m in the same period a year earlier.

But the good cheer did not last. The knock-on effect of the rise in the oil price in the past year is making the desperate plight of airlines critical once again. “Oil is robbing the industry of a return to profitability,” Mr Bisignani said in Washington this week. Delta has gone bankrupt despite a big refinancing last September, several efforts to shrink its network and lay-offs of over 7,000 employees—a tenth of its workforce. Northwest has been further damaged by a strike of maintenance workers since late August, forcing it to seek court protection from creditors through Chapter 11 bankruptcy.

Chapter 11 is a form of interim bankruptcy that allows companies to keep operating as a business while shedding some liabilities such as debts and financial obligations to a corporate pension fund. The value to shareholders is also wiped out, and new financial support is sought. The benefits of Chapter 11 are supposed to be avoiding the unnecessary liquidation of businesses, and the job destruction and total loss to creditors this can involve. But in the airline industry this emergency ward for stricken companies has turned into long-term intensive care, inadvertently wreaking further damage on rivals. In mid-October tougher new rules for Chapter 11 will come into force, so troubled airlines have an incentive to go bankrupt soon, to benefit from today's more benign regime.

Despite its signs of recovery in the second quarter, United had to announce six weeks ago that it was yet again postponing its planned emergence from bankruptcy. This is now scheduled for February. By then the airline will have spent 38 months under court protection from its creditors. And even this new deadline may not be met: a year ago United's boss Glenn Tilton was forecasting exit from Chapter 11 in March 2005. The more likely candidate for an early exit from bankruptcy is US Airways, which is in Chapter 11 for the second time in four years.

Under normal circumstances, consolidation in the airline business would be part of the process of recovery. But none of the stronger carriers, such as American or Continental, has the stomach to swallow a rival for fear of being landed with its problems. American bought the remnants of TWA more than four years ago, before the 9/11 attacks, and more or less closed it down afterwards. With the exception of America West, which was anxious to widen its geographical footprint and so agreed a merger with US Airways on September 13th, low-cost airlines have little appetite for less-efficient legacy carriers.

Oil prices are a problem for airlines worldwide. But in America, with its refineries stretched to capacity even before Hurricane Katrina knocked some of them out, the problem is even more acute. The shortage of refinery capacity means that jet fuel is competing with petrol and heating oil for space in the plants. This bottleneck has sent refinery margins soaring. So the price of oil translates into a price of $87 a barrel, once refining costs are taken into account.

Over a barrel

Crushed by such added costs and with the looming change for the worse in their treatment under the new bankruptcy rules, it is little wonder there is a rush for the protection of the courts. Predictably, the American carriers are also asking for more government help. They received a $2.5 billion hand-out after the 9/11 attacks grounded them and some, such as US Airways, qualified for

subsidised loans. But now they want the government to waive federal taxes on fuel surcharges to air fares, arguing that federal taxes on aviation are now 26 cents in the dollar, compared with only seven cents in 1972.

There is no sign of an end to the legacy airlines' agonies, since the fuel-price effect will corrode their earnings next year, and there is little prospect of oil prices sliding back much below $60. So the legacy airlines are trapped in a downward spiral. Every move they make to cut costs by removing trimmings from their cabin service or charging for meals and refreshments just brings them down to the level of service associated with low-cost carriers. The low-cost merchants, meanwhile, helped by their youthful, enthusiastic staff and their simpler, point-to-point routes, offer a standard of service that frequently outshines the networks, not least in terms of punctuality. As the number of routes offered by no-frills airlines increases, the legacy carriers are forced to retreat even further, making their residual networks less attractive because they offer fewer destinations.

The only bright spot for American carriers is international routes, where yields are rising steadily. But as they add capacity across the Atlantic, the bosses of European airlines such as British Airways are getting angry. They regard America's Chapter 11 bankruptcy as a form of subsidised, unfair competition. It looks as though the woes of America could spill over on to the international market.

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Economist.com BUSINESS

Hertz

Changing gear

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A global car-rental giant is the latest big company to go private

WITH a fleet of 12 Model T Fords, Walter Jacobs opened in Chicago in 1918 the rental business that was to become Hertz, now the world's biggest car-hire firm. In 1923, Jacobs sold his pioneering business to John Hertz. It was the first in a long series of ownership changes that continued this week with the announcement that Ford Motor Company, the main owner of Hertz since 1985, is to sell it to a consortium of three private-equity firms in a deal worth $15 billion in debt and equity.

This is arguably the biggest private-equity deal since the controversial purchase of RJR Nabisco for $25 billion in 1989. But it is unlikely to remain the biggest for long. Private-equity firms (which buy large, influential stakes in firms, often taking public companies private) have been raising huge sums from investors, they are increasingly willing to bid together on deals and borrowing money is currently cheap and easy—Hertz's buyers, for example, are borrowing over $12 billion. Indeed, some fear that private-equity firms are now so flush with cash that they are overpaying for firms coming onto the market.

To win Hertz, the consortium of Clayton, Dubilier & Rice (CDR), the Carlyle Group and Merrill Lynch Global Private Equity had to see off a rival private-equity consortium and Ford's original plan to spin off the car-rental firm through an initial public offering (IPO) of its shares. With its core carmaking business in trouble, Ford needs the money—and an IPO would have struggled to offload even 20% of the firm's shares, compared with the 100% that Ford is now selling to private equity.

Some industry analysts view the sale as a sign of a welcome increase in the urgency of Ford's efforts to solve its problems. Ford has also just reshuffled its top management, notably promoting Mark Fields to head its North American operations. Mr Fields promptly underscored Ford's difficulties this week by saying that its Jaguar luxury-car business may not return to profitability by 2007 after all.

But the sale is about more than Ford's need for money. Carmakers no longer see much added value in owning a rental business; and rental firms see little synergy in being owned by a carmaker. A captive rental firm used to be seen by big carmakers as a valuable source of demand for their cars, especially for those models that were hard to sell to anyone else. Before linking up with Ford—first, in 1965, via a joint-advertising deal—Hertz was owned from 1926 to 1953 by General Motors (which later bought a stake in Avis and then sold it in 1996). But the growing pressure on carmakers for better financial performance has reduced the appeal of selling lots of cars cheaply to high-volume buyers such as hire firms. Lately, the prices they charge hire firms have been rising. At the same time, the car-rental market, once mostly a collection of local monopolies, has become highly competitive. Rental firms—some of which have had financial troubles of late—can no longer afford to be a dumping ground for a carmaker's unwanted stock.

Hertz's new owners believe they can improve profit margins if demand remains strong, which it

should as long as nothing dents air-traffic volumes (much of the rental firms' business is done at airports). Improving profits will largely be a job for CDR, which is still rare among private-equity firms in having many partners with experience of running, and improving, big firms. George Tamke, a CDR veteran, will chair Hertz's board. A more recent CDR recruit, Jack Welch, the legendary former boss of General Electric, will chair thrice-yearly performance reviews. The biggest challenge for CDR may be to manage relations with the other members of its consortium. Until recently, CDR was sceptical about the viability of the increasingly fashionable private-equity consortium (“club”) deals: Mr Welch last year dismissed them as “gang bangs”. But, it seems, CDR now concedes that, partly because of the diversification rules governing private-equity funds, the only way to do really big deals is to join a club.

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Dow Jones

Paper chase

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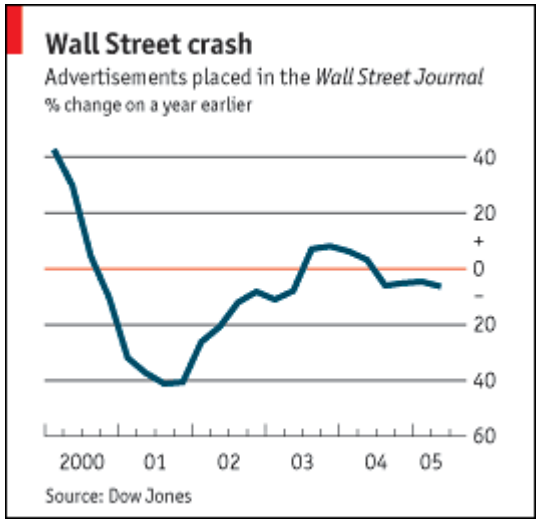
A new venture for an old paper



ON SATURDAY September 17th, Dow Jones, publisher of the *Wall Street Journal*, launches a new "Weekend" edition of the newspaper in America. It is a risky move, coming in the middle of an advertising slump and a fierce debate over the company's strategy and the quality of its management. If the new Saturday edition fails to attract a healthy amount of additional advertising, its chief executive, Peter Kann, a distinguished former journalist, may be pushed out before he is due to retire in three years' time. It is even possible that the Bancroft family, which controls Dow Jones, may decide to sell the firm. Last month the company's shares rose 15% following unconfirmed reports that some family members want to sell.

Business-to-business advertising, a key driver of profits at the *Wall Street Journal* and Dow Jones, has fallen precipitously since 2000, mainly because advertisers are moving to the internet. Because of particularly sharp declines in technology and financial advertising, the *Wall Street Journal*'s division of the company is barely profitable this year, despite being the leading business newspaper in the world, with some of the wealthiest readers.

Mr Kann's strategy with the Saturday edition is to broaden the *Wall Street Journal's* coverage further beyond business and finance and win a bigger share of consumer advertising, which is more buoyant than the business-to-business sort. The new paper will include articles on health and fitness, cars, travel, fashion, food, gadgets, entertainment and shopping. It will be posted free of charge to subscribers, and so will gain a circulation of at least 1.75m. The immediate question is whether advertisers will spend much more money on the paper. The *Wall Street Journal* already attracts consumer ads with its lifestyle coverage during the week, and some analysts worry that the new edition will cannibalise the weekday editions. (So far, claims Dow Jones, more than half of the advertisements it has booked for the Saturday paper represent additional revenue.) Another unknown is whether readers want a paper they associate with the working week at the weekend.

Even if the new edition brings in new money, that will not change the fact that the *Wall Street Journal,* which contributed about half of Dow Jones's revenues last year, relies on a type of advertising that may never fully return to newspapers. As a result, some people reckon a new print edition may be an expensive mistake.

"Print is in long-term secular decline," says Lauren Fine of Merrill Lynch, "so I am ambivalent about launching a print product, especially since WSJ.com has been so successful."WSJ.com now has nearly 750,000 paying subscribers, and Ms Fine also applauds the company's purchase of

MarketWatch, an internet-based provider of business information and analytical tools. The Saturday edition is an “absurd” project, says James Lowell, the Boston-based investment adviser to Hemenway & Barnes, a law firm which acts as the trustee to the Bancroft family, because there is little real demand for it from either readers or advertisers. Journalists at the paper are worried that if Dow Jones invests heavily in lifestyle coverage, business and finance may suffer. “As long as I am managing editor,” responds Paul Steiger, “there will be ample resources for our core coverage.”

Dow Jones's management has been under pressure for years. The company's shares have underperformed the Dow Jones Industrial Average by 49% in the past ten years, and the Standard & Poor's printing and publishing index by 56%. It is true that most newspapers are struggling with the internet's impact on advertising. What Mr Kann should be blamed for, his critics say, is the company's strategic failure since he took over in 1991 to broaden its mix of assets. Many shareholders and analysts, including Ms Fine, would welcome a change of management.

That depends on the more than 30 members of the Bancroft family, who own 30% of Dow Jones's shares and 62% of its voting rights. Some are unhappy, while others remain loyal to Mr Kann. If they were to put the paper up for sale, it would fetch an enormous price from one of a long list of buyers, including Rupert Murdoch's News Corporation, the New York Times Company and the Washington Post Company, who all doubtless believe they could run it better. Potential bidders have only a few months to wait and see whether the Saturday edition will protect Mr Kann, or hasten his departure.

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Economist.com BUSINESS

Oracle and Siebel

The Godfather

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There is no escaping Larry Ellison

A MACABRE sort of reunion is taking place in the software industry, hosted by Oracle, the world's third-largest software-maker after Microsoft and IBM. In the 1990s, Larry Ellison, Oracle's demanding boss and the industry's *bête noire*, drove many of his lieutenants to leave his firm. Some set up their own companies, and a small diaspora of ex-Oracle employees settled throughout the San Francisco Bay Area.

Craig Conway, the gentlest of the bunch, went on to run PeopleSoft, which became for a time the market leader in applications for personnel departments. Tom Siebel, whose ego rivals Mr Ellison's, launched Siebel Systems, which for years dominated the market for customer-relations-management software, which salespeople use to keep track of their marketing leads. Marc Benioff founded Salesforce.com, to do the same sort of thing, with the twist that it hosts the software on its own computers and lets customers rent access to it through their web browsers (just as consumers access Amazon, Hotmail or eBay).

During the technology boom of the late 1990s, the first three—Messrs Ellison, Conway and Siebel—basked in their roles as poster-children of the new era. Then, in 2000-01 the bust came, and they hit hard times. Oracle, which was the leader in database software but was also branching out into selling applications, suffered, but remained huge. PeopleSoft and Siebel, however, went into decline. Siebel, in particular, was hurting, attacked on one side by the German applications vendor SAP, which became the market leader, and on the other by Mr Benioff's Salesforce.com, which started picking off small and medium-sized customers who were drawn to Salesforce.com's simple, intuitive service.

As the industry entered recession, Mr Ellison began to preach that the software industry would never recover and had to be consolidated, and that he was the one for the job. Regularly offending rivals with this and other comments, he launched a hostile bid for PeopleSoft in 2003. Bad feelings that were swept under rugs for a decade burst out on both sides, and the two companies sued each other for over a year until PeopleSoft finally gave up and was acquired last February. Mr Ellison, energised by the controversy, bought three other small companies for good measure.

Siebel Systems, meanwhile, was putting up a fight. Last year, Tom Siebel stepped down as chief executive (but stayed on as chairman) and hired an IBM veteran, Michael Lawrie, to turn his firm around. Mr Lawrie did his best. Then, in April, Mr Siebel fired him and hired another chief, George Shaheen. He was best known for running Webvan into the ground in 2001, making it a symbol of the dotcom bust. But Siebel Systems kept losing market share and revenues. Its spokespeople were reduced to planting unsettling gossip about the dynamic upstart, Salesforce.com.

On September 12th, this chapter closed, as Siebel Systems at last surrendered, agreeing to be bought by Oracle for $5.8 billion. Mr Benioff, whose Salesforce.com is going from strength to strength and who was launching yet another ground-breaking product in San Francisco on the same day, took time out to gloat. “Oracle put Siebel investors out of their misery today,” he wrote

to his employees. “We have been doing that for Siebel customers for years.”

With Siebel's disappearance, the major bout of consolidation in the corporate-software industry probably comes to an end. There is barely anybody left. In the obscure “infrastructure” layers of corporate data-centres, there is now an oligopoly of giants such as IBM, Oracle and Microsoft, with a few stragglers such as BEA Systems still hanging on. In the applications layers, Oracle, having digested PeopleSoft and Siebel, will be a sort of Airbus to SAP's Boeing. Mr Ellison and Mr Benioff are still at large and preening, while other members of the diaspora are gradually settling down. Things will be duller.

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Economist.com BUSINESS

Turkey

Flocking to the Bosporus

Sep 15th 2005 | ANKARA
From The Economist print edition

Privatisation takes off

WHEN the Turkish government proclaimed that 2005 would be “the year of privatisation”, many foreign investors were sceptical. The Turkish economy began to liberalise over two decades ago, but successive governments failed to privatise the country's lumbering and corruption-addled state-run companies. But now things are really happening—and previously cynical investors are flocking to Turkey, as one potentially lucrative enterprise after another is sold off.

The latest sale—on September 12th—was of a 51% stake in Tupras, an oil refinery, for $4.1 billion, to a consortium of Turkey's Koc Holding and Royal Dutch/Shell. The sale propelled the Istanbul Stock Exchange to a record high. It follows the privatisation in late August of a 55% share in state-run Turk Telekom, to Saudi Oger and Telecom Italia, for $6.55 billion. Global steel giants, including London-based Mittal and Luxembourg-based Arcelor are competing for a 46% chunk of Erdemir, a highly profitable steelworks, that is to be auctioned on September 26th. Turkey has already pushed through $14 billion in privatisation deals this year—and the total could reach $20 billion by the end of 2005.

Other forms of foreign investment may also shoot up if Turkey begins long-anticipated membership negotiations with the EU as planned on October 3rd. Turkey's image had been badly damaged by a legal case involving Motorola and Nokia in which they claimed to have been defrauded of over $3 billion by a failed Turkish company. But a recent compensation deal agreed with Nokia has repaired some of that damage.

Things could still go wrong, however. It would be a problem if the petroleum workers' union, which successfully challenged the sale of a 65.7 % block of Tupras last year, wins another case it filed immediately after this month's auction. Telecom workers have launched similar proceedings to reverse the Turk Telecom deal. Turkey's judicial system is notoriously politicised and Ahmet Necdet Sezer, the country's fiercely nationalist president who is opposed to the sale of “strategic national assets”, has publicly backed many of the obstacles to privatisations erected by court decisions.

Privatisation is also stoking suspicions between secularists and Islamists in Turkey. Secularists have expressed alarm at the recent flow of Arab money into Turkey, claiming it is part of a broader scheme to pull Turkey away from the West. Ironically, however, western bankers are keen that the government should ignore all such talk and press ahead with privatisation.

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Economist.com BUSINESS

Pan-European companies

Limited appeal

Sep 15th 2005 | FRANKFURT
From The Economist print edition

One giant step across Europe may find few imitators

IT IS a grand title with a grand idea behind it. The idea of a Societas Europaea (SE), a company based and regulated in the European Union as a whole, rather than a single nation, has been around for at least 30 years. But it was not until September 11th this year that Allianz, Europe's biggest insurer, became the first big company to opt for pan-European status, announcing the move as part of a merger and business restructuring. The legal groundwork for SE status was put in place only in October last year with the passage of EU legislation which, in theory, allows this new animal to operate seamlessly across the 28 countries of the European Economic Area (the EU and three neighbouring countries).

But there has hardly been a rush to sign up: only a handful of firms, headed by Strabag, an Austrian road-builder, have done so. One reason is continued uncertainty about tax treatment and aspects of corporate governance, as well as the slowness of some European countries to adapt their national laws. Moreover, for smaller European firms, setting up a limited company under British law is cheaper than opting for SE-status—and arguably allows the same freedoms.

Allianz decided on the SE structure as the best way to take over and integrate RAS, a 55.4%-owned insurance subsidiary in Italy, into its other European businesses. By creating a European company (Allianz SE, based in Munich), and making a tender offer in Italy for the balance of RAS shares, Allianz avoids the irksome task of squeezing out reluctant shareholders at a later date—which it would have to do under German takeover law. Michael Diekmann, chief executive, has made a virtue of these tactics by stressing that Allianz is becoming a European rather than a German company—the kind of Europhile rhetoric that always plays well in Germany.

“It's Auf Wiedersehen Deutschland AG,” jokes an Allianz source. Not quite. Allianz will not streamline its management into a single board, as the legislation would allow. Its two-tier board structure will remain, although the supervisory board will be reduced from 20 members to 12. Nor will Allianz abandon the German principle of worker representation: half of the supervisory board will still be workers' representatives, but they will be drawn from the whole of Europe rather than from Germany alone.

But SE status might make relocation to Luxembourg more feasible, if Allianz ever finds German tax or regulation intolerable. Some analysts think that regulatory arbitrage could tempt SEs to migrate to the friendliest European regimes, just as Delaware attracts companies in America.

So will the SE bandwagon now gather pace? The signs are not encouraging. This month Vossloh, a German railway technology group, postponed its SE plans, including the creation of a single board, after a battle between the chief executive and his supervisory board chairman. Suez, the French industrial group, is exploring the use of an SE vehicle in its planned takeover of Electrabel, the Belgian power company—but it is awaiting Belgian approval, and France has not yet adopted SE legislation. Airbus, Europe's aircraft-making joint venture and the very symbol of co-operative European industrial enterprise, is still registered in France and has managed for years without

creating a pan-European legal entity.

Meanwhile, rulings by the European Court in favour of allowing any European company to operate in any other European country could make SE status seem redundant and expensive. Setting up the simplest limited-liability company in Germany costs around €1,000 ($1,220) and requires €25,000 in working capital. By comparison, set-up costs in Britain can be less than €300 for a German company, and start-up capital need not exceed £1 ($1.82). Michael Silberberger, who runs Go Ahead Ltd, with offices in Birmingham and Wiesbaden, says his firm has advised 14,000 German companies on their change to British limited status. He estimates that 18,000-20,000 German firms have taken this step—lured by the easier regulatory environment and corporate-governance rules. They tend to be small or medium-sized: the biggest so far is Müeller Ltd & Co KG, a pharmacy chain with 16,500 employees, based in Ulm.

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Economist.com BUSINESS

Reality TV in China

The sorcerer's apprentice

Sep 15th 2005 | HONG KONG
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Chinese television embraces entrepreneurs

CROSSING swords with the “The Donald” is not something to be undertaken lightly. But Vincent Lo, a successful Hong Kong and mainland China property tycoon, is about to clash with Donald Trump, his famous American rival, for the second time in two months—and looks likely to come out ahead again.

Their first confrontation came over a piece of prime New York real estate, which the former business partners sold for $1.76 billion in June. That was $1 billion too little, according to Mr Trump, who says he was not consulted. He sued, promptly lost this August and is now suing again. With that court case rumbling on in the background, the two men are taking their fight to the airwaves. Mr Lo is backing a Chinese reality-television programme modelled on “The Apprentice”, the show that put Mr Trump, with his catch-phrase “You're fired!”, into living rooms across America. Mr Trump is hitting back with plans to launch a Chinese version of his original format. Both shows will be shown across mainland China. But the Trump version will not be ready until October, while Mr Lo's 13-part series, “Wise Man Takes All”, premieres this weekend, on September 17th.

There are other reasons to believe that “Wise Man” may prove more suited to Chinese tastes. Just like “The Apprentice”, it will feature two teams of contestants trying to outdo each other in completing a business task. But this 30-minute recorded slot will be followed by a live half hour during which the contestants present real-life business plans, to be judged by a panel of business professors (with Mr Lo making the occasional appearance). The winner, instead of getting a job, will receive 1m yuan (about $120,000) in start-up funding from Mr Lo's company Shui On to back his or her idea. Rather neatly, Mr Lo, who is as understated as Mr Trump is brash, has thereby avoided the need to publicly lecture, bully or “fire” anyone, a treatment that would leave a Chinese audience squirming in embarrassment.

To be fair, the host of the upcoming Chinese “Apprentice”, Pan Shiyi, also promises not to use the phrase “You're fired”, saying he will politely tell failed contestants that they “have better opportunities elsewhere.” But Mr Pan, a well-known Beijing property developer, is notorious for sacking his worst-performing sales agent every three months. The Chinese “Apprentice” is therefore likely to be much more aggressive than “Wise Man”. That may make better television. But even with a 1m yuan-a-year job at Mr Pan's company on offer as the prize, it also risks offending.

Whichever format succeeds, the real winner is China's private sector. This receives little praise from the government, despite providing three-quarters of China's economic output. The growing popularity of business and financial programmes—and even games shows—reflects a rising level of comfort with entrepreneurs and the pursuit of wealth. After all, regulators are now permitting these new programmes, and reputable TV groups, such as the state-controlled Shanghai Media Group, are producing them. In addition, advertisers are flocking to them.

Ten thousand people sent in business plans for “Wise Man” and the final 16 selected came from every corner of China, including a 31-year-old from the far north who wants to start hostels for backpackers in Beijing and a 24-year-old technology whiz who created his first software company at 16. Naturally, given China's territorial claims, there is also a Hong Konger and a 39-year-old Taiwanese pop star who wants to run a website for the online management of singers. While the programme promises to be entertaining, Mr Lo, who will base the winner at his new centre for start-up firms in Shanghai, says its real task is to foster future business leaders. “Many of us are entrepreneurs at heart,” he says. Surely, that is something he and Mr Trump can agree on.

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Economist.com BUSINESS

Face value

The resurrection of Steve Jobs

Sep 15th 2005
From The Economist print edition

Getty Images

That which does not kill the boss of Apple seems to make him stronger

Get article background

ONE morning, about a year ago, a doctor told Steve Jobs that a cancerous tumour in his pancreas would kill him within months, and that it was time to start saying his goodbyes. Later that night, an endoscopy revealed that the tumour could be cut out. But for one day Mr Jobs, the boss of Apple Computer, as well as Pixar, the world's most successful animation studio, stared death in the face.

The experience seems to have invigorated him. Last week, gaunter but otherwise undiminished, he was on a stage in San Francisco, putting on a show (for that is what Apple product launches are) that was as flashy and dynamic as any as he has ever thrown. When businessmen try to rub shoulders with pop stars, the effect is usually embarrassing. But “Steve” had arranged to have his pal, Madonna, pop up on screen and kidded around with her with panache. Does she have an iPod? Of course she has! “That's so duh,” said the superstar playfully. Then Mr Jobs segued into his announcements—a new mobile phone from Motorola that has iTunes, Apple's music software, pre-installed and that represents a beachhead into the world of phones; and the “iPod nano”, a new digital music-player that is thinner than a pencil, but still holds 1,000 songs.

For Mr Jobs, the product launch seemed mainly to be an opportunity to drive home the message

that his hold on downloaded and portable music now seems overwhelming. iTunes sells 2m songs a day and has a world market share of 82%—Mr Jobs reckons that it is the world's second-largest internet store, behind only Amazon. And the iPod has a market share of 74%, with 22m sold. For a man who helped launch the personal-computer era in 1976 with the Apple I, but then had to watch Microsoft's Bill Gates walk away with, in effect, the monopoly on PC operating systems (Apple's market share in computers today is less than 3%), this must be some vindication.

The odd thing about near-death experiences—literal or metaphorical—in Mr Jobs's life is that he seems actually to need them sporadically in order to thrive. Mr Jobs himself suggested as much when he addressed the graduating class at Stanford University in June. Until he turned 30 in 1985, Mr Jobs led a life that fits almost every Silicon Valley cliché. He dropped out of college (like Bill Gates and Michael Dell); he started a company with a friend in a garage (like everybody from Hewlett and Packard to the founders of Google); he launched a revolution (the PC era). Big deal. The interesting event occurred when he was 30 and got fired from his own company, after Apple's board turned against him. He was “devastated”. His career seemed dead.

Characteristically, though, Mr Jobs bounced back, once he realised, as he said at Stanford, that “the heaviness of being successful was replaced by the lightness of being a beginner again.” He did something uninterrupted success might have made impossible: he became more creative. In 1986 he started two new companies, NeXT, a computer-maker that was always too far ahead of its time, and Pixar, an animation studio that went on to have a series of box-office hits. A decade later, ironically enough, NeXT was bought by Apple, and Mr Jobs was brought back to run the company he had founded.

Mr Jobs, a pescatarian (ie, a vegetarian who eats fish) with a philosophical streak and a strong interest in the occult, interprets these reversals as lessons. As befits a man who grew up in California in the 1960s, he proclaims his belief in karma and in love. Not necessarily love of his employees, apparently—some of whom have found working for him a nightmare—but love of one's ideals. Always do only what you love, and never settle, he advised the students at Stanford. His brush with cancer, in particular, seems to have focused his mind. “Death is very likely the single best invention in life,” Mr Jobs told his young audience. “All external expectations, all pride, all fear of embarrassment or failure—these things just fall away in the face of death, leaving only what is truly important.”

Do not get the impression that Mr Jobs is now hugging strangers in random acts of kindness. He is still testy, irascible and difficult; he is still prepared to sue teenagers who publish Apple gossip on their websites for alleged abuses of trade secrets. But the reminders of mortality have changed him. “He was already softened” after his public humbling in 1985, says Bruce Chizen, the boss of Adobe Systems, a software company that is a long-time partner of Apple's. After the cancer, he says, “he's even softer” and, Mr Chizen reckons, even more creative.

New toys on the way

Mr Jobs's rivals may feel the same way. The digerati in Silicon Valley, Redmond (Microsoft), Tokyo (Sony), Seoul (Samsung) and other places now simply take it for granted that Mr Jobs has a top-secret conveyor belt that will keep churning out best-selling wonders like the iPod. What could these toys be? A portable video player is rumoured. A new and cooler sort of television is possible. A user-friendly and elegant mobile-phone handset would be nice, perhaps called something like “iPhone”.

Hollywood and music studios are also increasingly frightened. The music studios, which barely took him seriously when he launched iTunes in 2001, are sick of his power and are pressuring him to change his 99-cents-per-song flat rate for music. Slim chance. Disney, a long-time partner of

Pixar whom Mr Jobs broke with when he got tired of its former boss, is now trying to worm its way back into his favour.

In short, Mr Jobs currently seems vivacious by anybody's standards. There are even rumours that he might run for governor of California (as a Democrat, presumably; Al Gore is on Apple's board). For somebody famous in large part for a spectacular defeat—to Bill Gates and Microsoft—all this must feel like a new lease of life, in every respect.

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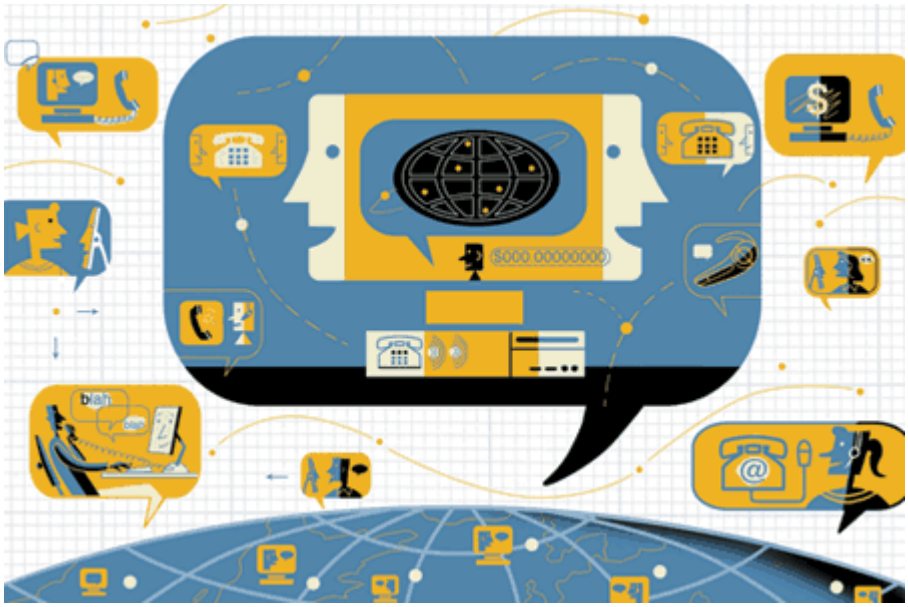
Economist.com BUSINESS

Telecoms and the internet

The meaning of free speech

Sep 15th 2005 | LONDON AND SAN FRANCISCO
From The Economist print edition



The acquisition by eBay of Skype is a helpful reminder to the world's trillion-dollar telecoms industry that all phone calls will eventually be free

NIKLAS Zennstrom and Janus Friis, the founders of Skype, which distributes software that lets people make free calls from their computers to other Skype users anywhere in the world, don't usually travel to America. Legally, they probably could. But they prefer to avoid that jurisdiction, since they also founded (and subsequently sold) KaZaA, a peer-to-peer software company whose product many people use to share copyrighted songs. So setting foot in America could invite some legal trouble. This does not mean, however, that they cannot appear at conferences in Silicon Valley, where Skype—which uses the same basic idea of KaZaA, but applies it mainly to voice communication—is considered the next big thing.

Thus, in July, Mr Zennstrom appeared, via a Skype video call, on the screen of a packed auditorium at Stanford University, while sitting in Estonia next to Tim Draper, a venture capitalist who invested $10m in Skype. Mr Draper is the ultimate loud American, whereas Mr Zennstrom is a sombre Swede. “He's already taken down one industry and he's on to the next one,” hollered Mr Draper—referring to recording studios and telecoms companies. Mr Zennstrom started shifting uncomfortably. “I never wanna sell my stock until it's a hundred billion,” Mr Draper yelled, then started singing and dancing. The blushing Mr Zennstrom was speechless.

Of course, Mr Draper was posturing. That became clear on September 12th, when Skype announced that it had agreed to be taken over by eBay, based in Silicon Valley and the world's largest online marketplace. Mr Draper and Skype's other investors will get nothing like $100 billion, but eBay is paying a hefty sum—$2.6 billion in cash and shares and perhaps more if certain

criteria are met—nonetheless.

This pairing took many people by surprise. There have been rumours that Yahoo!, Google, Microsoft and other technology companies were also interested in buying Skype. Any of these might have made a more obvious fit, since each also has instant-messaging software that can be used for free phone calls (or “voice chats”, as opposed to text chats) between computers. Google, the world's most popular internet search engine, launched its own voice-chat software in August. A week later, Microsoft bought Teleo, a San Francisco company that lets people call conventional telephones from their computers (as Skype also does, for $0.02 a minute). Yahoo! had already bought Dialpad, another Skype-like firm, in June. AOL, Apple and others have similar products.

As Meg Whitman, eBay's boss, and Mr Zennstrom explain it, a combination of eBay and Skype is not all that far-fetched. From eBay's point of view, placing cute Skype buttons on the web pages where people trade used cars, houses and other items that usually require voice bargaining “reduces friction”, says Ms Whitman. Buyers can simply click on the button and talk to sellers. Another idea is to make money from “pay-per-call” advertising, where advertisers would place voice links (ie, Skype buttons) on certain pages just as they now place text links on, say, the search-results pages of Google. Whenever a web surfer clicks on one of these links and talks to a salesperson, the advertiser would pay eBay and Skype a fee. Google got rich by doing this in the text world; there is no reason why eBay might not be able to do it in the voice world.

From Skype's point of view, the deal strengthens its existing link with PayPal, eBay's online bank, which it uses to charge for services such as calls from computers to conventional telephones (called SkypeOut) or from conventional phones into Skype (called SkypeIn). This involves prepaid accounts, which Skype users can top up via PayPal with their credit cards.

For Skype, however, the main attraction may be that eBay, unlike the other potential suitors, plans to leave it largely alone, both as a brand and as a business. “When Yahoo! and Microsoft buy companies, they typically disintegrate them,” says Mr Zennstrom. His vision for Skype, by contrast, is to become the world's biggest and best platform for all communications—text, voice or video—from any internet-connected device, whether a computer or a mobile phone.

This is every bit as audacious as it sounds. Mr Zennstrom, in general, is a modest man. But his company is only three years old, will probably make only $60m in revenues this year, and will certainly not turn a profit. So it is the fact that his ambition is not nearly as ridiculous as it sounds that should make incumbent telecoms firms everywhere break out in a cold sweat.

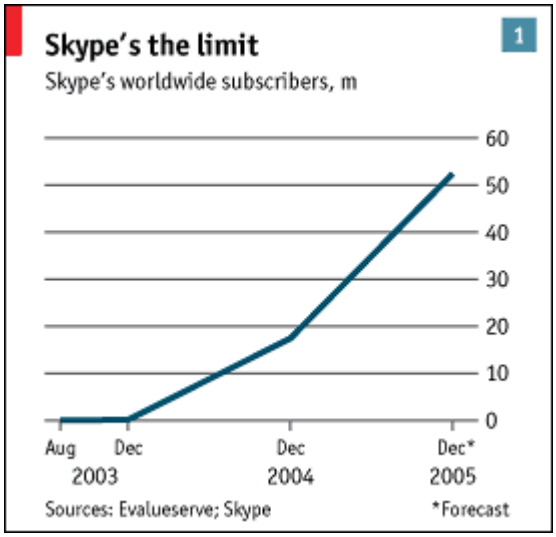
That is because Skype can add 150,000 users a day (its current rate) without spending anything on new equipment (users “bring” their own computers and internet connections) or marketing (users invite each other). With no marginal cost, Skype can thus afford to maximise the number of its users, knowing that if only some of them start buying its fee-based services—such as SkypeOut, SkypeIn and voicemail—Skype will make money. This adds up to a very unusual business plan.

“We want to make as little money as possible per user,” says Mr Zennstrom, because “we don't have any cost per user, but we want a lot of them.” This is the exact opposite of the traditional business model in the telecoms industry, which is based on maximising the average revenue per user, or ARPU. And that has only one logical consequence. According to Rich Tehrani, the founder of *Internet Telephony*, a magazine devoted to the subject, Skype and services like it are leading inexorably to a future in which all voice communication, near or far, will be free.

End of the line

The technical term that encompasses all forms of voice communication using the internet is voice-over-internet-protocol, or VOIP. This includes pure computer-to-computer calling as well as the various hybrid states, such as a Skype user connecting to the traditional telephone network, or even two people talking on seemingly conventional phones that are linked, behind the scenes, via the internet. It also includes residential VOIP providers such as Vonage, based in New Jersey and the market leader in America with over 1m subscribers, that supply their customers with adapters so they can plug ordinary telephones into their broadband connections without using a computer.

Sandvine, a telecoms-equipment firm, estimates that there are 1,100 VOIP providers in America alone. But the trend is worldwide. IDC, a market-research firm, predicts that the number of residential VOIP subscribers in America will grow from 3m at the end of 2005 to 27m by the end of 2009; Japan already has over 8m subscribers today. Worldwide, according to iSuppli, a market-research firm, the number of residential VOIP subscribers will reach 197m by 2010. Even these numbers, however, do not include people using VOIP without subscribing to a service (ie, by downloading free software from Google, Skype or others). Skype alone has 54m users.

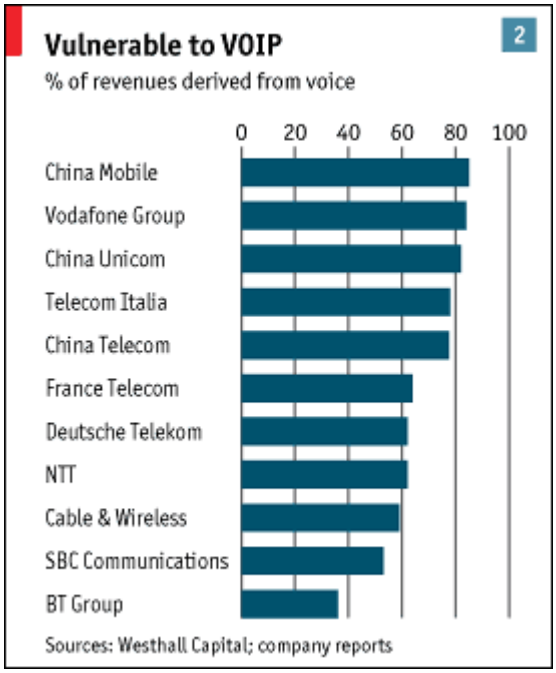


Even before VOIP makes 100% of telephone calls in the world completely free (which may take many years), it utterly ruins the pricing models of the telecoms industry. Factors such as the distance between the callers or the duration of a call, the key determinants of cost today, are simply irrelevant with VOIP. Vonage already lets its customers choose telephone numbers in San Francisco, New York or London, no matter where they live. A Londoner calling the London number is making a "local" call, even if the Vonage subscriber is picking up the phone in Shanghai. As when checking e-mail on, say, Hotmail, the only thing needed is a broadband-internet connection, but it can be anywhere in the world. Sooner or later, people will discard their unwieldy phone numbers altogether and use names, just as they do with their e-mail addresses, predicts Mr Zennstrom.

Call duration is also becoming irrelevant. "A lot of people open a Skype audio channel and keep it open," says Mr Zennstrom. After all, it costs nothing. Many people with Apple computers are already accustomed to this. They open an application called iChat, which is a video and voice link, and stay connected to their loved ones far away. Increasingly, members of a family or a business team can stay online throughout the day, escalating from unobtrusive instant-messaging ("Can you talk?") to a conference call, a video call and back to a little icon on their screen.

It is thus altogether wrong to call this phenomenon the end, or death, of telephony. "Calling it the death of telephony suggests people aren't going to make calls, but they are," says Sam Paltridge,

a telecoms guru at the OECD. “It's just the death of the traditional pricing models.” In short, all this is great news for consumers and awful news for telecoms operators. “VOIP will destroy voice revenues faster than most analysts' models predict,” says Cyrus Mewawalla, an analyst at Westhall Capital. “Voice will very rapidly cease to become a major revenue generator for all telecoms operators, fixed and mobile.”



That said, some telecoms carriers are much more vulnerable to VOIP than others, says Mr Mewawalla. Telecoms operators offer and charge for a number of services besides pure voice calls. Because VOIP will cause only the revenues from voice calls to shrink, it will hit those operators hardest that are most dependent on their revenues from voice (see chart 2).

For pure mobile operators, such as Vodafone or Taiwan Mobile—as it happens, Taiwan is the country with the highest ratio of Skype users—VOIP could be an “enormous problem”, says Mr Mewawalla, because voice accounts for over 80% of their revenues. By contrast, VOIP is less threatening to integrated operators (ie, those offering both fixed and mobile services) such as Deutsche Telekom or Japan's NTT. And those carriers—such as BT, France Telecom or KPN—that are currently building next-generation networks based on internet technologies will be able to offer VOIP services themselves, bundled with other offerings, and might emerge relatively unscathed.

Some operators are taking an unenlightened view by trying to delay the advance of VOIP. China Telecom has been blocking access to Skype from Shenzen, according to local newspaper reports. Vodafone has introduced wording into new contracts for some German subscribers reserving the right to block VOIP in future, though a spokesman for the company says it is not doing so at the moment. Clearwire, an American wireless-broadband provider, also reserves the right to block VOIP traffic. In February, Madison River Communications, a rural phone company in North Carolina, was fined $15,000 by regulators for blocking access to Vonage's VOIP service. Occasionally, operators have even blocked access to Skype's website, thus preventing people from downloading the software or topping up their calling credit.

The more enlightened approach—which most operators in rich countries, to varying degrees, accept—is to compete with VOIP openly or even to embrace it. Already, says Mr Paltridge, pricing of traditional phone services is changing quite radically as operators “try to adjust and to compete

with the Skypes of this world". Operators are moving towards flat-rate pricing plans for traditional telephone service, so that the marginal price of making calls falls to zero. Many American regional operators offer unlimited local and national calling for a fixed monthly fee, and such schemes are also becoming popular in other countries.

Several incumbent operators have also launched their own VOIP services, such as Verizon's VoiceWing and BT's Broadband Voice. These offer lower prices than traditional telephone service but are generally not as cheap as a call between Skype and a regular phone. "If you can't beat 'em, join 'em," says John Delaney of Ovum, a consultancy. Such services are an admission that a less lucrative VOIP customer is better than no customer at all. Switching to VOIP also helps operators by lowering their own costs dramatically. BT and others are building new, internet-based networks behind the scenes, which will carry all voice traffic as VOIP even if the calls start or end in the traditional way.

The other argument for embracing VOIP is that the incumbents can then start offering the fun new services that VOIP makes possible and charging for them. This goes far beyond traditional voicemail. Video-conferencing and unified messaging—whereby all forms of communication, from voicemail and video messages to e-mails or entire electronic documents go into one virtual "inbox"—will become common, says Wendy McMillan-Turner, head of voice services at BT. Since all of these features are essentially software programmes, they can all be integrated with applications that people today use on their computers, such as Outlook calendars and contacts files.

The service that many telecoms operators are most excited about, however, is IPTV, which refers to television (and entertainment in general) being delivered over new and super-fast broadband-internet connections into homes. This would allow them to charge for a bundle of services, including broadband access, entertainment and voice. The voice component could then atrophy gracefully and eventually be thrown in for nothing. "Ultimately—perhaps by 2010—voice may become a free internet application, with operators making money from related internet applications like IPTV," says Mr Mewawalla.

Cable operators are coming at VOIP from exactly the opposite direction. They already offer television and entertainment, as well as broadband access, so they might as well offer cheap telephony as well. This puts the cable companies in a good position. Unlike the telecoms operators, they do not depend on voice for their revenues today, so they can use cheap VOIP service as a competitive weapon to make life difficult for the telecoms operators, who are increasingly their only competition. In California, for example, most people have a choice between one cable company, Comcast, and one traditional telecoms carrier, SBC. Since voice uses very little bandwidth compared with television, the cable companies need not even add a lot in the way of bandwidth.

The result, says Mr Mewawalla, is that voice service is fast becoming a marketing freebie to make customers "sticky"—to keep them loyal. "I would expect people to advertise free calls with VOIP, subsidised by other elements of the package," says Ms McMillan-Turner. Thus, BT will consider value-added services sold around VOIP as voice revenues in future, she says. BT hopes that selling such services will offset the inevitable decline in traditional voice revenue. Evalueserve, a consultancy, predicts that American and European fixed operators' long-distance voice revenue will decline by around 40% by 2008, and that in Europe 50% of broadband users will give up their voice lines by 2008.

Mobile operators face a far greater challenge than fixed-line carriers. Voice accounts for the bulk of their business and they cannot (at least today) offer broadband access as easily as the cable and fixed-line companies. New "third-generation" (3G) networks were supposed to make possible whizzy new data services to compensate for flat and even declining revenues from voice calls, but

consumer adoption has been slow.

Worse, those very 3G networks that are supposed to provide future growth for the industry could now undermine it, since they make possible VOIP calling over mobile networks. Already, one mobile operator, E-Plus in Germany, has announced a deal that will allow subscribers to use Skype on its 3G network. Users would thus pay only for the internet connection, while making free calls to other Skype users and to other telephones for very little. E-Plus hopes to win valuable business customers and to put pressure on much bigger but less agile rivals such as Vodafone.

Today, VOIP calling over 3G networks is still very much a minority sport, but as 3G coverage and transmission speeds improve—something the industry is racing to achieve—it will become common. This represents a mortal danger for mobile operators. “VOIP on mobile is the first real threat they are going to face, and they are in a state of shock,” says Mr Mewawalla. Mobile operators generally charge three to five times as much as fixed operators for each minute on the phone, so they have far more to lose from falling voice prices. International travellers will use VOIP over hotel-room broadband links or Wi-Fi hotspots in airports to save on the roaming charges by their mobile-phone company.

Vodafone counters that, like BT, it is moving towards internet-based networks that will reduce its own cost of carrying calls and make possible new value-added services. But this sounds unconvincing. Much more so than fixed-line operators, mobile operators would have to cannibalise their current business in order to generate new revenues from VOIP. Ironically, this means that BT, once regarded as a dinosaur-like incumbent, is now being held up as a shining example of an operator that is embracing the future, while Vodafone, whose pure-mobile strategy once seemed visionary, now stands accused of being on the wrong side of history. At the end of the day, there is no getting around the reality, as Skype's Mr Zennstrom says, that “something that is a great business model for us is probably a terrible business model for them.”

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Economist.com FINANCE & ECONOMICS

Insurers and Hurricane Katrina

Assessing the damage

Sep 15th 2005 | MONTE CARLO
From The Economist print edition

Reuters

The insurance industry gasps at the cost of New Orleans's great hurricane

THE sun was brilliant, the Mediterranean sparkling, the Bentleys and Lamborghinis polished to perfection in front of the Hotel de Paris. It might have been just another care-free day in Monte Carlo. But across the plaza the chatter under the awnings at the Café de Paris was far from light-hearted. There, the world's insurers and reinsurers were counting the cost of a hurricane 5,000 miles away.

September's rendezvous in Monte Carlo, one of the year's biggest international gatherings of reinsurers and their clients, often seems to occur at a time of crisis. In 2001, the usual networking ground to a halt as those attending clustered around television sets, watching in horror as the World Trade Centre collapsed with scores of their colleagues inside. Last year, there was a string of devastating hurricanes in Florida. This week, the general view was that Hurricane Katrina has been the toughest blow in a long time, with as many as 2m claims expected. “I've been in the industry for 30 years,” said Paul Markey, chairman of Aon (Bermuda), a large broker. “This is like nothing I've seen.”

The final tally of losses from Katrina will not be known for some time. At the high end of estimates, RMS, a catastrophe-modelling firm, puts insured losses at $40 billion-60 billion, which would make Katrina by far the costliest natural disaster insurers have ever faced (see

table). However, depending on how responsibility is parcelled out between America's federal flood-insurance programme (see article) and private coverage for storm damage, business interruption and so forth, the bill could be lower—or much higher. There is already talk of legal action in Louisiana to settle claim disputes.

Nature's bill

Biggest insurance losses from natural disasters

	Date	$bn*
Hurricane Andrew *US and Bahamas*	Aug 1992	21.5
Northridge earthquake, *US*	Jan 1994	17.8
Hurricane Ivan *US and Caribbean*	Sep 2004	11.0
Hurricane Charley *US and Caribbean*	Aug 2004	8.0
Typhoon Mireille, *Japan*	Sep 1991	7.8
Winter storm Daria *France and Britain*	Jan 1990	6.6
Winter storm Lothar *Western Europe*	Dec 1999	6.6
Hurricane Hugo *Puerto Rico and US*	Sep 1989	6.4
Hurricane Frances *US and Bahamas*	Aug 2004	5.0
Tsunami, *Indian Ocean*	Dec 2004	5.0

Source: Swiss Re *2004 dollars

Reinsurers, which absorb extreme risks from primary insurers, are likely to pay a big chunk. Quite how big is still anyone's guess. This week Swiss Re, the world's second-biggest reinsurer, increased its estimated pre-tax losses from Katrina from $500m to $1.2 billion, or 7% of shareholders' equity. It will probably have to dip into its reserves to meet the claims. Swiss Re says it will still pay a dividend, assuming "normal business development" for the rest of the year.

Smaller reinsurers may be worse off. According to *Insurance Day*, a trade publication, the second-biggest maximum losses so far are at Montpelier Re, a Bermudian reinsurer, which expects a hit of up to $675m, or 46% of shareholders' equity. Some firms are already under strain. Several reinsurers have said that they will need to raise more capital. Alea, another Bermudian firm, which was in difficulty before Katrina hit, has been downgraded by Standard & Poor's, a rating agency. However, the Lloyd's of London insurance market said on September 14th that it expected all its syndicates to withstand the blow. It estimated the cost to be £1.4 billion ($2.6 billion).

Because Katrina-related claims are likely to absorb so much capacity from the global reinsurance industry, premiums are expected to rise not just in America, but worldwide. "Rates will come up whether you're talking about Dutch motor insurance or US catastrophe reinsurers," predicts Tim Carroll of GE Insurance Solutions. Energy-insurance rates have already started rising: increases of up to 25% have been reported for renewal premiums outside the Gulf of Mexico.

Following yet another disastrous year in America, insurers elsewhere are becoming increasingly irked by such side-effects. Of course, catastrophes are not unique to America—look at the floods in Mumbai in July, or in the Alps last month—but the frequency and scale of American claims seems unrelenting.

"It will not be easy for the small guy with a motor car in Europe to accept an increase in his premium due to Katrina," says Jean-Philippe Thierry, host of this week's gathering and president of AGF, a French insurer owned by Allianz, a German giant. He contends that in the past couple of years, America has accounted for about 75% of the world's natural-catastrophe claims, while paying only about half of the premiums.

So far, it is unclear how many companies will follow Allstate, a primary insurer in America that has declared it will no longer write certain property and casualty policies in Florida because of storm risk. With two other big American insurers, State Farm and St Paul Travelers, Allstate has especially large exposure where Katrina struck. A $36.3m bond offering for the New Orleans levee system was cancelled on September 10th when MBIA, the world's largest bond insurer, terminated its agreement to insure the debt because of damage caused by Katrina.

"If I were heading a big reinsurer," says Mr Thierry, "I might ask, 'Why do I stay in this business when it seems to be dangerous?'" General Electric has indicated that GE Insurance, hardly a

minnow, may be sold in an initial public offering when the time is right. But, adds Mr Thierry, most big players will choose to stay in America, the world's biggest market for non-life insurance. “The strong, small guy may think this is a good time to sell,” he says.

With the prospect of rising rates after Katrina, though, potential new investors are watching for opportunities. There were rumours at this week's gathering that money was available. Hedge funds have been drawn to the reinsurance industry in recent years, especially in Bermuda, and there is speculation that they will increase their investment. In the past year, hedge funds have provided capital for start-up reinsurers such as Swiss-based Glacier Re (backed in part by George Soros's Soros Fund Management) and CIG Re (backed by Citadel Investment Group, of Chicago).

In paying so much attention to Katrina this week, the industry had little time to ponder its other worries. Among these is the small matter of terrorism risk, especially in America. A federal programme known as TRIA, set up to stabilise the insurance industry after the attacks of September 11th 2001, will expire at the end of the year unless Congress keeps it alive. Industry experts say that insurers are reaching the limits of the terrorism risk they can take on in big city centres. They fear that rates will shoot up. It was scarcely a relief from talking about Katrina for insurers in Monte Carlo to listen to a panel of experts discussing the threat of terrorism worldwide. “I've got seven grandchildren,” said one of the speakers afterwards, wearily. “I hope they won't be coming to meetings like this in 30 years.”

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Italian banks

Capitulation

Sep 15th 2005
From The Economist print edition

After a tortuous battle, a foreign takeover of an Italian bank is in sight

AP

THE seven-month saga of the takeover of Banca Antoniana Popolare Veneta (Antonveneta) looks all but over. Late on September 14th, after a marathon meeting, the board of Banca Popolare Italiana (BPI) announced that it favoured the sale of its 29.5% stake in Antonveneta, Italy's ninth-largest bank, to ABN Amro, of the Netherlands, for about €2.5 billion ($3.1 billion). The Dutch bank, which already owns a similarly sized slice of Antonveneta, is keen to acquire BPI's stake as well as the remaining shares.

Assuming the deal goes ahead, it will herald Italy's first big cross-border bank takeover. ABN Amro looks set to win its prize despite the resistance of Antonio Fazio, the governor of the Bank of Italy, who has blocked foreign attempts to buy domestic banks throughout his 13-year tenure. Another foreign bid, by Spain's Banco Bilbao Vizcaya Argentaria for Banca Nazionale del Lavoro (BNL), failed in July. This week Consob, Italy's financial-market watchdog, approved a €4.9 billion bid for BNL by Unipol, an Italian insurer. The central bank and the insurance regulator are expected to approve the deal as well.

Mr Fazio has not only lost the battle for Antonveneta. Through his manoeuvres to keep Antonveneta in Italian hands he has damaged the Bank of Italy's hitherto fine reputation. He has little credibility as an impartial overseer of Italian banking. And he has frustrated foreign investors at a time when the Italian economy could do with interest from abroad.

The battle for Antonveneta started about seven months ago when ABN Amro launched a bid for the bank. As soon as Antonveneta's board had accepted it, BPI stepped in, pulling every available string to thwart the Dutch. It increased its stake in Antonveneta to 29.5%, just below the trigger set by Italian law for a mandatory cash offer for the rest of the shares. It lent money to several Italian businessmen to buy shares in Antonveneta without disclosing the loans. At a shareholders'

meeting in April it teamed up with its allies to replace Antonveneta's board with a new one friendly to itself. And in June it launched its own bid for the target bank.

Mr Fazio has denied all accusations that he has acted improperly. Still, all this happened on his watch. Moreover, telephone conversations tapped by magistrates, who suspected that BPI was breaking the rules and had placed Gianpiero Fiorani, its boss, under surveillance, suggest that Mr Fazio intervened time and again to favour BPI's bid. However, the bank's manoeuvres led to a judicial inquiry and to the suspension of both Mr Fiorani and BPI's offer.

Now Mr Fazio is facing almost daily calls to resign. Italy's deputy prime minister and finance minister are among those who have called on him to go. The law, however, gives Mr Fazio life tenure. The government decided a few weeks ago to curtail the power of any successor when Mr Fazio does eventually leave, one way or another. With the governor's wings clipped and ABN Amro's success in sight, foreign banks ought to feel emboldened to take another look at Italy's fragmented banking sector.

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Economist.com FINANCE & ECONOMICS

The World Bank's "Doing Business" report

Unblocking business

Sep 15th 2005
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A helpful exercise in quantifying business regulations and their costs

SERBIA does not often come top of global economic league tables. But according to the World Bank's latest report on "Doing Business" around the globe, the country slashed more red tape last year than any of the 154 other countries in the study. This January, Serbian entrepreneurs needed 15 days and a deposit of €500 ($650) to start a business, compared with 51 days and €5,000 a year earlier. Taxes are now easier to pay, debts easier to collect and temporary workers easier to hire. As a result, start-ups have boomed: the number of registered firms leapt by 42% in 2004.

Tale of the tape

Regulation of business start-ups

Number of procedures required

Lowest		Highest	
Afghanistan	1	Chad	19
Australia	2	Uganda	17

Number of days needed

Lowest		Highest	
Australia	2	Haiti	203
Canada	3	Laos	198

Cost, % of income per person

Lowest		Highest	
Denmark	0.0	Zimbabwe	1,442
New Zealand	0.2	Sierra Leone	835

Minimum capital requirement

Lowest		
46 countries		nil
Highest	**% of income per person**	**$**
Syria	5,112	60,832
Yemen	2,703	15,408

Source: World Bank

Starting a business is always a "leap of faith," the report says. But that faith is needlessly tested by misguided regulations. In Laos, it takes 198 days to start a business, and not because the queue of budding entrepreneurs is terribly long. In Sierra Leone, a firm foolish enough to pay its taxes in full would have to part with 164% of its gross profits—ie, everything it earns and more. Those bold enough to import goods into Africa lose eight days on average to the continent's ill-equipped ports and nine to its poorly-surfaced roads; but they lose an epochal 43 days to paperwork and customs inspections.

In a free market, companies prosper by making better use of resources than their rivals. In the poorest parts of the world, where resources are scarce, this function is more vital than anywhere else. Unfortunately, African governments do more than any others to inhibit the spirit of competitive capitalism. The 16 countries of West Africa managed just two reforms between them last year. Mauritania was the only country in the world to raise its corporate income tax in 2004.

Heavy strictures on business often fail even on their own terms. In poor countries, stringent building codes do not always produce safer habitation; higher tax rates do not always pull in more revenue; and the most tightly regulated labour markets do not afford the best protection to workers. Often, such burdens simply drive firms and workers into the shadow economy, beyond the reach of inspectors, trade unions and the taxman.

Furthermore, firms pushed underground are less productive: they cannot take advantage of economies of scale, because they must stay small to stay hidden. On average, the Bank reckons, formal companies produce 40% more than informal enterprises in the same industries.

Burkina Faso is one of the worst examples. The country's name means “land of honest and upright people”, but only 50,000 of its 12m population work in the formal sector. This is partly because the cost of firing someone is so high: equivalent to 57 weeks' wages. It is also needlessly difficult for Burkinabes to make an honest business out of their grey-market enterprises. The minimum capital a firm must deposit is nearly five times the country's average income per person. Burkina Faso's people may be upright, but its businesses stoop in the shadows.

Thankfully, the Bank's indicators are helping to solve the problems they measure. “It is like sports,” says Simeon Djankov, an author of the report, “If you keep score, no one wants to lose.” In the past, the Bank has been coy about publishing its full league table, for fear of offending the governments at the bottom. But this year there is nowhere for the losers, such as Burkina Faso (ranked 154th), Egypt (141st) or even Italy (70th, below Kenya) to hide.

Mr Djankov reckons that 21 different reforms over the past two years were inspired by the “Doing Business” audit, which costs just $2m to carry out and disseminate. It is, in short, a promising way for the World Bank itself to do business.

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Economist.com FINANCE & ECONOMICS

The OECD on China's economy

A model of reform

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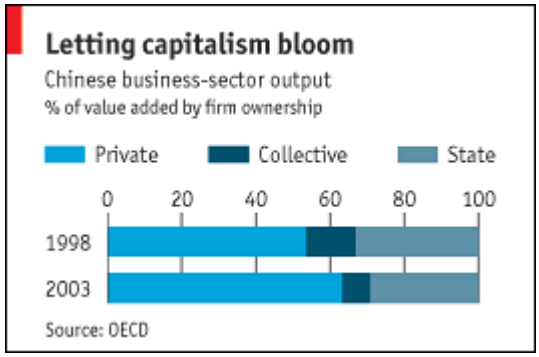
Some advice from the rich man's club

Get article background

THE Organisation for Economic Co-operation and Development has long urged its mainly rich member countries to push ahead faster with structural reforms. Now, in its first full survey of China's economy, the Paris-based club has turned its attention to a non-member whose rapid pace of reform, along with its low levels of public spending and borrowing, would put many European countries to shame.

The report oozes praise for China's bold reforms over the past quarter-century, which have allowed market forces a much bigger role in the economy and opened it up to foreign competition and investment. No member of the OECD has embarked on reforms that have restructured or closed thousands of state-controlled firms every year, with millions of job losses. The number of state firms has tumbled from over 300,000 to 150,000 in the past decade.

This has been offset by rapid growth in the private sector. The OECD estimates that in 2003 private companies accounted for 63% of China's business-sector output (which in turn accounts for 94% of GDP). This compares with 54% in 1998 and virtually nothing in the 1970s. If you add in "collective" enterprises, which are officially controlled by local government but in practice operate more like private firms, the private sector's share was 71% in 2003 (see chart). By now it is probably close to three-quarters. Nevertheless, that still leaves state enterprises' share of output well above that in OECD countries.



In collaboration with China's National Bureau of Statistics, the OECD has analysed a new financial database covering around 160,000 firms. It finds that the average rate of return on capital for private-sector industrial firms rose from 8% in 1998 to 15% in 2003, thanks to rapid growth in total factor productivity (TFP: the efficiency with which both capital and labour are used). That was higher than the average return on capital in OECD countries of around 11%. Once state-controlled firms are included, however, China's average return drops below the OECD mark. State firms' return on capital rose from 5% to 10% between 1998 and 2003, but most of that improvement was accounted for by a minority: two-thirds of state firms make less than 5%, and 35% still make a loss.

Private-sector firms' TFP is double that of their state-controlled counterparts. As a result, the shift of resources from the public to the private sector boosts productivity. Over the 25 years to 2003, the annual growth in TFP averaged 3.7%. It slowed to 2.8% by the end of that period, but that was still much faster than in OECD countries. For instance, America's TFP growth has averaged

about 1% over the past decade.

The OECD reckons that China can maintain its rapid pace for some years, as long as reforms continue. More aggressive restructuring in the public sector would help to boost economy-wide productivity growth. And to support the expansion of private business the OECD urges a reform of corporate law (to remove barriers to the entry and expansion of new firms), bankruptcy law and property rights. Measures to develop and deregulate China's financial markets would also help to improve the allocation of capital.

Although China is a poor country, it shares many of the problems of OECD countries. It needs labour-market reforms to increase mobility. It faces the burden of an ageing population. And its public sector is inefficient. The OECD should invite China to join its club—not just so that China can benefit from its experience, but also to ensure that the OECD itself does not become irrelevant by excluding the world's emerging economic giant.

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Economist.com FINANCE & ECONOMICS

Property derivatives

Fear of flying

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Britain's fledgling property-swaps market stretches its wings

IT MAY not set everyone's pulse racing. But the formal launch in London on September 16th of the Property Derivatives Interest Group (PDIG) is a big step for a new and crucial market which may serve as a model for property trading elsewhere. Foreign exchange, bonds, equities, commodities: all have been transformed over the past couple of decades by the emergence of large, liquid markets in derivatives (swaps, options, futures, structured products and the like). Only property, on some measures the biggest asset class of them all, has failed to follow suit. Past attempts to bring this illiquid corner of the investing world into the modern age have collapsed. Will it be different this time?

Yes, probably, but don't expect fireworks. Since regulatory and tax problems were resolved (the latter late in 2004), upwards of £600m-worth ($1.1 billion) of property derivatives of various stripes have been traded. That is only a smidgen in a British commercial-property market with assets worth more than £600 billion. Pension funds, property companies and other investors own just under half of this, according to the Investment Property Forum (IPF), the professional association that is PDIG's parent. Sales of actual properties in the first eight months of the year were at least £28 billion, up from £25 billion a year earlier, estimates Property Data, a research firm. So derivatives have a way to go, even if they hit the £1 billion mark this year as some predict.

That is where PDIG comes in. “Unless the people who make the decisions understand property derivatives, nothing will happen,” says Iain Reid, chief executive of Protego Real Estate Investors and PDIG's new chairman. PDIG aims to spread the word through information, workshops and the like. And in case that is not enough, a virtual-trading tournament organised by Hermes Property Asset Management will bring together 30 or more of the most important property players, beginning next month. The idea is to help them learn how the market might work, in realistic but anonymous circumstances, and so strengthen their confidence in it.

Essentially, derivatives allow investors to buy and sell exposure to the property market without having to buy and sell actual buildings. Investors do this by betting on whether the Investment Property Databank (IPD) index, a measure of income and capital appreciation with 28 years of live data behind it, will rise or fall.

Derivatives are good news, for several reasons. Property-transaction costs are typically 7-8% of the value of the deal, while pure swaps cost just 0.5%, according to Deutsche Bank, one of the banks active in the market. It can take months to complete a property deal, leaving cash idle on the balance sheet, while a swap could be transacted in an afternoon. For those who like property but need to minimise their exposure to it, derivatives offer a way to shed risk while retaining high-yielding physical assets. Other indirect forms of property investment—mutual funds or shares in property companies, for example—often have high costs attached and, like direct investment, require a knowledgeable eye for winners.

Many property folk are prepared in theory to enter the market for swaps and swap-related bonds: in a recent IPF survey, 74% of the professionals polled had a mandate to use property derivatives and 63% were preparing to do so. Brokers from the financial-derivatives world are piling in too: GFI, for example, set up a joint venture in July with CB Richard Ellis, Britain's biggest commercial-property firm. The trouble is, says Paul Coleman of Barclays Capital, the bank credited with founding the market, “it's a long pipeline and though it's full, there's no guarantee that something will come out any time soon.” And there are still some constraints.

The first is that because so few derivatives have been issued, they lack liquidity—a problem that even credit derivatives, now a $5 trillion market, originally faced. Because property has been so profitable (the total-return index has risen by 77% over the past five years), it is harder to find investors willing to sell the index than it is to find receivers, though views are becoming more varied. And it is not yet possible to peel off sub-sectors reliably—trading out-of-town shopping centres against City office blocks, for example—where some think the real appeal of the market lies.

If they finally fly, however, derivatives will transform the market, making it more agile, more transparent and easier to hedge. By permitting property investors to reduce their exposure without dumping physical assets, they may also—just possibly—help to bring over-enthusiastic property prices down to earth more gently than would otherwise be the case. And that, surely, is worth a little leap of faith.

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Economics focus

Asian squirrels

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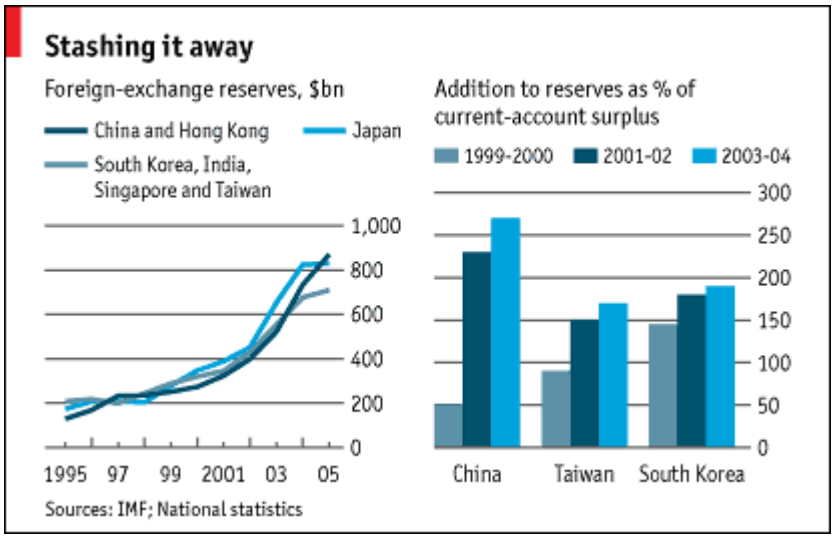
The enormous build-up of foreign-exchange reserves in Asia is less sinister than it looks

ON ONE economic measure at least, China has overtaken Japan: it now has the world's largest foreign-exchange reserves. The combined reserves of the People's Bank of China and the Hong Kong Monetary Authority stood at $833 billion at the end of June. By now, given their recent rate of growth, they could be nudging $870 billion-worth, most of this in dollars—well ahead of the $830 billion in Japan's coffers at the end of last month. Asia as a whole now has a stash of more than $2.5 trillion, two-thirds of the world total, up from $1 trillion in 2000.

A new report*, published by the International Centre for Monetary and Banking Studies in Geneva and the London-based Centre for Economic Policy Research, explodes some popular myths about the causes and likely consequences of this enormous stockpile. For instance, some American economists and politicians assert that the build-up of reserves in Asia proves that the region's governments are intervening on a huge scale to keep their currencies undervalued as part of a mercantilist strategy of export-led growth. If they let their currencies rise, it is argued, America's external deficit would shrink painlessly. By any measure, Asia's reserves far exceed its needs. However, the authors of the report dispute the claim that this growth in reserves is the product of a deliberate plan to keep currencies cheap.

Asia's critics often focus on countries with fixed exchange rates. In fact, holders of the seven biggest reserves exhibit a range of currency systems, yet have all seen similar increases (see left-hand chart). Until this year, the biggest build-up had been in Japan, whose currency floats. Of the seven, only China and Hong Kong had formal pegs to the dollar, and in July China shifted to a managed float against a basket of currencies. The other four countries (South Korea, Singapore, Taiwan and India) have varying degrees of flexibility. For instance, the South Korean won has risen by 28% against the dollar since 2002.



The motive for accumulating reserves differs by country. Japan, for example, has been battling against deflation. Selling yen for dollars was widely seen by foreign economists and policymakers as a sensible tactic in this fight. The aim was not just to hold down the yen, but also to expand Japan's monetary base and thus to reflate the economy.

Nor does the mercantilist story fit the facts in emerging Asian economies. Current policy is largely a response to the East Asian financial crisis of 1997-98. Before then, most of these countries ran large current-account deficits and had severely overvalued currencies. When their reserves ran out, devaluation was forced upon them; it was not a planned policy choice. Indeed, at the time of the crisis, they were criticised for not letting their currencies fall sooner. More recently, most countries have allowed some rise in their exchange rates against the dollar, but governments have understandably been eager to rebuild their reserves as ammunition against any future crisis.

It is also hard to accuse China of running a cheap-currency policy, since it passed up an opportunity to devalue the yuan at the time of the Asian crisis. Moreover, an increasing proportion of the expansion of China's reserves has reflected inflows of hot money betting on a revaluation of the yuan. In 2004 China's addition to its reserves was three times bigger than its current-account surplus. More generally, trade surpluses have not been the main cause of the increase in Asian reserves. In many other economies, the growth in reserves has been twice as large as their current-account surplus (see right-hand chart), thanks to inflows of foreign direct investment and speculative capital. In other words, rising reserves need not imply currency manipulation in the strict sense implied by the IMF Articles of Agreement.

One would normally expect to see a current-account surplus offset by an outflow of capital as the private sector exported excess domestic savings. But Asian countries still have relatively underdeveloped financial systems. Central banks have instead performed as intermediaries, using the surplus dollars to accumulate foreign reserves.

Shifting the blame

In any case, a revaluation of Asian currencies would have little impact on America's current-account deficit. The only real cure is for Americans to save more. The increase in China's external surplus has anyway been far too small to account for America's deficit. Between 1997 and 2004, China's current-account surplus widened by $36 billion, while America's deficit expanded by $529 billion. The external position of all the rest of emerging Asia improved by $125 billion. The combined surplus of commodity exporters (the Middle East, Russia and Latin America) rose by

much more: $233 billion.

But even if undervalued Asian currencies are not the main cause of global imbalances, that does not mean that the build-up of excessive reserves in Asia is healthy. Does it make sense for economies to put so much money into low-yielding American Treasury bonds? One solution is for countries to split their reserves into a liquid portfolio (ie, Treasuries) and a separate national wealth portfolio. As an example of the latter, the authors propose the setting-up of an Asian Investment Corporation, which would pool some proportion of reserves and manage them on commercial lines with greater freedom to invest in higher yielding assets such as company shares and bonds.

Another problem is that heavy buying of dollars has inflated money supplies and pushed down interest rates. The danger is that cheap money leads to a misallocation of capital, undermining future growth. Even if Asia's exchange-rate regimes are not to blame for America's deficit, they still might not be in these countries' long-term interest. Policymakers may have drawn the wrong lesson from the Asian crisis, believing that bigger reserves are the best way to avoid a future crisis. The correct lesson is that currencies should become more flexible.

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* “Official Reserves and Currency Management in Asia: Myth, Reality and the Future”. Geneva Reports on the World Economy 7, September 2005

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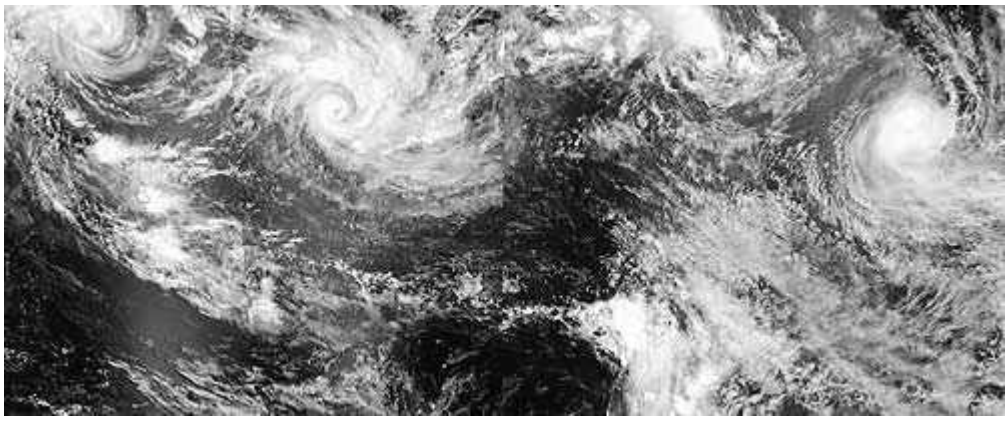
Economist.com SCIENCE & TECHNOLOGY

Hurricanes

Storm surge

Sep 15th 2005
From The Economist print edition

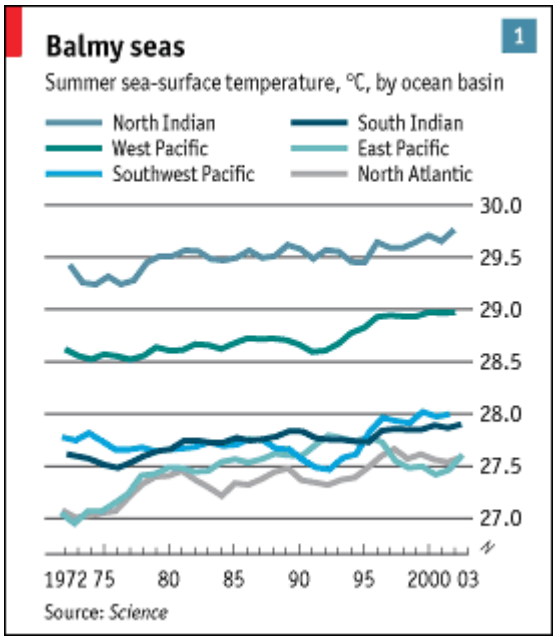
Jeff Schmaltz, MODIS at NASA, GSFC



The most damaging types of hurricane are getting more frequent

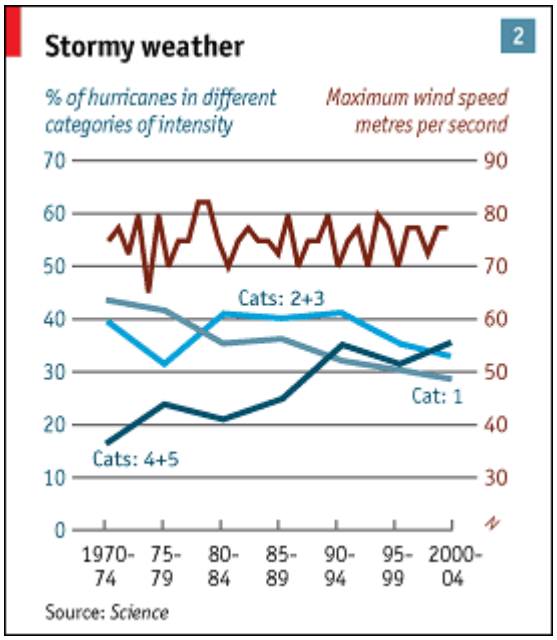
AMID the handwringing that has followed the devastation of New Orleans by Hurricane Katrina, a persistent question whispered in the background has been whether hurricanes are getting worse. A paper in this week's *Science*, by Peter Webster of the Georgia Institute of Technology, in Atlanta, and his colleagues suggests that they are, but only in one, specific way.

Hurricanes can form only over oceans that have a surface temperature above 26°C. That is well known. What is debatable is what effect, if any, raising the temperature beyond that has. It might increase the number of storms, the length they last, their maximum strength or the proportion that are strong. Or it might have no effect. Since average ocean-surface temperatures have risen by about half a degree since 1970, this is not an idle question, and it has, indeed, been asked in the past. But it has been asked largely of the North Atlantic and North Pacific, because they are fringed by countries that can afford to do the asking. Dr Webster, by contrast, has looked at the whole planet—or, rather, the six ocean basins on its surface that act as hurricane nurseries.



He and his team used satellite data to obtain consistent observations from around the world. (This was the reason they were able to go back only as far as 1970; before that, there were not enough observations.) Analysing the sea-surface temperatures in the six basins (the North Atlantic, the West Pacific, the East Pacific, the Southwest Pacific, the North Indian Ocean and the South Indian Ocean), they found statistically significant temperature rises in all but the Southwest Pacific.

Looking at the hurricanes themselves, though, they found no long-term trends in the number of storms per ocean basin or the length a storm lasts, except in the North Atlantic, where both increased. That is unfortunate news for Caribbean countries and the United States, which bear the brunt of those storms. But it suggests that whatever is increasing hurricane incidence it is not—or, at least not solely—to do with ocean warming. If it were, such increases would have shown up in other places where the sea is getting warmer.



Nor was there any increase in the maximum windspeed that storms attained anywhere. What there was, however, was a doubling around the world of the proportion of storms in the most destructive categories (4 and 5 on the Saffir-Simpson scale usually employed by meteorologists). And, although the exact rise in that proportion varied from basin to basin, all of them saw a significant increase.

What caused that increase is, of course, debatable—and since the second-largest percentage increase was in the Southwest Pacific, where no significant temperature rise was observed, leaping on changes in sea-surface temperature as the sole cause might be premature. But what Dr Webster and his colleagues have shown beyond much doubt is that something rather nasty has been happening. Time, perhaps, to batten down the hatches.

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Economist.com SCIENCE & TECHNOLOGY

Ecosystem services

Greening the books

Sep 15th 2005 | NEW YORK
From The Economist print edition

The environment may yet appear in the accounts of companies and countries

COSTA RICA'S environment minister, Carlos Manuel Rodríguez, has a plan to make people take his kind more seriously: “We need to learn the language of finance and economics, and demonstrate the economic benefits of the environment.” When he said it this week at a UN gathering, the room burst out laughing.

But his notion may not be that outlandish. Costa Rica is already a leader in recognising the “ecosystem services” provided to the broader economy by healthy watersheds, unmolested forests and so on. And this week, the World Bank has joined Mr Rodriguez's side by publishing a report arguing that current measures of a country's economic welfare, such as gross national product, are inadequate since they ignore the value of a country's natural assets.

When national accounts are expanded to include not only “produced” wealth (goods and services), but also intangibles (such as knowledge) and especially natural wealth, they reveal some interesting patterns. Natural capital makes up a big part of the wealth of the poorest, but not the richest. That, argues the report, makes it all the more important for governments in poor countries to manage their natural resources wisely. Alas, many do not.

To be clear, the bank's boffins, led by Kirk Hamilton, do not argue that nature should be fenced off and development quashed. The point is the wise use of natural assets. After all, the world's rich countries were once poor, and they used their natural resources to help themselves grow. As they got richer, they raised environmental standards, reforested denuded lands and so on. America, much maligned by greens, nonetheless earns strong marks for its overall management of natural assets. Many poor countries, by contrast, are squandering their natural capital.

The United Nations Environment Programme added its voice in a separate report on market greenery also released this week. This analysis argues that well-directed investments in the environment (such as terracing agricultural land to slow erosion) often have payback rates of three dollars or more for every dollar invested. It also makes the claim that, if the price of greenhouse-gas emissions (measured as the weight of carbon in carbon dioxide) stays above $30 a tonne, then countries will find it cheaper to conserve forests as carbon “sinks” than to chop them down.

Governments have slowly started to take account of natural capital, but whether they will shift the basis of national accounts as the World Bank suggests is more doubtful. Margaret Beckett, Britain's environment secretary, is sceptical. While supporting the idea of valuing ecosystem services, she expresses doubt about whether Britain will move from conventional GDP measures to “green GDP” anytime soon. She has, however, thrown her weight behind a project that has similar objectives to the World Bank's but is aimed at corporate, rather than national, accounting methods. The Carbon Disclosure Project (CDP), a coalition of big institutional investors, aims to force companies to list the true (but often hidden) liabilities they may face from global warming among their financial disclosures.

The scheme started out in a small way in Britain about five years ago, but has grown to become the world's biggest register of corporate greenhouse-gas emissions. The CDP makes these data available free for all to see. The hope is that even in America, where there is no federal law forcing cuts in carbon-dioxide emissions, the transparency that the project provides will help mobilise companies to act—if only to appease the CDP's members, who control an impressive $21 trillion in assets.

In time, Mrs Beckett argues, firms that act on emissions may see ways of developing business as well as avoiding costs. She points to General Electric's recently launched “Eco-magination” campaign, which is meant to profit from low-emission technologies, as an example. Who knows? If all environment ministers abandon tree hugging in favour of such talk of profit and loss, then Mr Rodríguez's dreams may yet come true.

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Economist.com SCIENCE & TECHNOLOGY

Abolishing addiction

Brainwashing

Sep 15th 2005
From The Economist print edition

A new way to treat drug abuse (in rats, at least)

A DRUG addict's brain alters in response to the drugs he takes. There is the instant change that provides the chemical high, of course, but there are also more subtle, long-term modifications. It is these that turn a user into an addict. Some of them are responses to the drug itself. But some are responses to the circumstances in which the drug is taken. Such things as viewing the paraphernalia of drug taking, for example, serve to remind abstinent addicts of forbidden pleasures and tempt them to relapse.

Two pieces of research just published in *Neuron*, a specialist journal, suggest that it is possible to impair the brain's memory of such associations—at least, if the brain concerned is a rat's. Courtney Miller and John Marshall, of the University of California, Irvine, have worked out how to disrupt the memories that cocaine-taking rats develop for the place where they get their fix. And a team led by Jonathan Lee, of the University of Cambridge, has prevented rats from using environmental cues to seek cocaine.

Three regions of the brain are thought to be linked to addiction: the prefrontal cortex, the nucleus accumbens and the amygdala. All three have a multitude of receptors for a chemical called dopamine, which is part of the nervous circuitry involved in the perception of desire, and all are involved in the laying down of long-term memories.

That process, surprisingly, is not a one-off event for each memory. Every time a memory is recalled, it seems to be actively refiled afterwards—a process known as reconsolidation. This is why people are vulnerable to suggestion when recalling memories of, for example, childhood abuse. Observing this, Dr Miller and Dr Marshall wondered if they could manipulate the refiling process to abolish a memory altogether.

To do so, they first had to establish the memory they wanted to abolish. They did this by putting their rats into an apparatus containing two chambers and teaching them to associate one of those chambers with cocaine use. (Rats are at least as keen on Bolivian marching powder as humans are.) The two “rooms” had different colours, textures and smells, so the rats could easily tell them apart. In normal circumstances, when trained rats were allowed to chose which room to enter, they preferred to spend most of their time hanging out in the cocaine chamber even when no cocaine was available.

Having established this preference, Dr Miller and Dr Marshall then sought to abolish it using a drug that inhibits the production of a protein called Extracellular Signal-related Kinase. This protein, which is generated in the core of the nucleus accumbens, causes long-term changes in gene expression that are thought to be involved in the storage and retrieval of memories, including those of drug use.

Two days after being trained to associate one of the chambers with cocaine, the rats were divided into three groups. Some were given the inhibitor drug and then returned to their cages. Some

were given it and then returned to the two chambers. And some were first returned to the two rooms, giving them the opportunity to remember the cocaine chamber, and were then given the inhibitor drug. In these tests, rats in the first group—who had not been given the opportunity to retrieve their memories of cocaine when they received the treatment drug—preferred to spend time in the cocaine chamber. But rats in the other two groups showed no particular preference for either room. Their previously strong memories had become disrupted.

Dr Lee and his colleagues, meanwhile, were studying the amygdala. This part of the brain serves as a “Pavlovian” learning machine that associates a pleasurable event, such as being fed, with a neutral event, such as the sound of a bell ringing. Dr Lee's rats learned that they received cocaine when they poked their noses into a particular hole. At the same time, a light went on. The rats were then put into a similar set-up, but this time they received no cocaine when they poked their noses into the hole, and there was no light.

Dr Lee and his team then treated their rats to shut down the gene that produces a protein called Zif268, which seems to have a similar role in the amygdala to that of Extracellular Signal-related Kinase in the nucleus accumbens. (They did this using pieces of “anti-sense” DNA that attach themselves to the gene in question and stop it being read by the cellular machinery that transcribes genes.) Several days later, the rats were returned to the test site, but this time two levers had been installed in it. One of these levers did nothing. The other lit the light associated with cocaine use. The rats who had not received the treatment pressed the lever that lit the light many more times than did the rats who had received the injection, suggesting that only they remembered the light's association with cocaine.

Both teams of researchers believe that the amnesia they have induced relates only to memories of drug use, because those were the memories that were being recalled at the time the inhibitor drugs were given. That will bear further investigation. But if it is true, and drug-related memories can be abolished without affecting other memories, then this work might be a first step on the road to a therapy that would eliminate the powerful urges addicts experience when in the social situations in which drugs are taken.

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Economist.com SCIENCE & TECHNOLOGY

Electroconvulsive therapy

Shocking treatment

Sep 15th 2005
From The Economist print edition

How ECT works

ERNEST HEMINGWAY underwent 20 gruelling rounds of electroconvulsive therapy (ECT) to cure him of his depression. Having lost many of his memories as a result, he said, “It was a brilliant cure but we lost the patient,” and took a shotgun to his head not long afterwards. Ever since ECT was pioneered by Ugo Cerletti, an Italian neurosurgeon, in the late 1930s, it has had a bad press. In books (“The Bell Jar”, “Zen and the Art of Motorcycle Maintenance”), in song (“Electric Co” by U2) and in film (“One Flew Over the Cuckoo's Nest” and “Tarnation”), it has been portrayed as a sinister procedure that leaves the patient a dribbling dullard. But in spite of this, ECT remains one of the fastest-acting and most effective antidepressant treatments known.

Why it should be so effective, though, is an enigma. On the face of it, running a current of almost an amp through someone's brain seems a silly thing to do. But a study by Johan Hellsten of Lund University in Sweden has cast some light on the question. Dr Hellsten has shown that ECT leads to the generation of new blood vessels in part of the brain implicated in depression.

Previous brain-imaging studies have shown that patients with long-term depression have a smaller hippocampus (part of the brain that deals with emotion and memory) than average. But, while it is possible to use scanners to look at brain volume in people, it is impossible to examine what is going on at a cellular level. For this reason, Dr Hellsten used rats.

There were two groups of rats in his experiment. The test group received ECT once a day for ten days while the control group received a sham treatment. On the eleventh day, the rats were killed and examined. Dr Hellsten found a 20-fold increase in the number of endothelial cells (the cells that line blood vessels) in the hippocampuses of the test rats, compared with the control rats. He also found a 16% increase in the total length of the blood vessels in their hippocampuses. If the blood vessels of any organ—including the hippocampus—are reduced, that organ begins to atrophy. ECT appears to reverse this atrophy. This study is the first to show an increase in blood-vessel production in connection with an anti-depressive treatment.

Why ECT has this effect is still a subject of speculation, but Dr Hellsten suspects that what is happening is a consequence of the brain trying to protect itself. ECT works by creating an artificial epileptic seizure. Natural seizures, which often last much longer than the 30 seconds or so employed for ECT, result in the production of chemicals called growth factors that stimulate cell division and growth. This response helps to compensate for the damage that a seizure can do. Though modern ECT does not last long enough to cause damage, it nevertheless provokes the damage-limitation response.

ECT, invented in a more brutal age, was originally seen as a way to control unruly patients, often against their will. Ironically, it now serves to give will back to those who have lost it.

Economist.com BOOKS & ARTS

Art from Russia

The big haul

Sep 15th 2005 | NEW YORK
From The Economist print edition

Russia's most famous paintings are off to the Guggenheim. Don't miss them

THE scale of the great Russian art collections dazzles even the knowing visitor. You can go to the Hermitage in St Petersburg expecting to see Old Masters and French post-impressionists, but scarcely to see room upon room of them unfolding into the distance, all humbling masterpieces, the legacy of spendthrift tsars and of prodigal pre-revolutionary collectors such as Sergei Shchukin and Ivan Morozov, whose pictures were seized by the Bolsheviks. You can go to the Tretyakov Gallery in Moscow, or to the Russian Museum in St Petersburg, expecting to discover Russian painters little known in the West, but even so, it is a shock to find dozens of them crowding in there, masters of landscape and of human drama, proof that Russia's artistic genius was second only to that of France in the 19th and early 20th centuries.

A core sample of Russian art down the centuries has been shipped westward to the Guggenheim Museum in New York, for a new exhibition entitled “Russia!”. The exclamation mark is typographically irritating, but it catches the excitement which this show means to provoke. There is surprise, shock or delight in almost every one of the 250 pieces. Most are Russian paintings, save for 30 or so sculptures and a dozen foreign works from the 17th and 18th centuries. The best have been known to all Russians from childhood as national treasures, and will be sorely missed this winter by visitors to the Hermitage, the Tretyakov and the Kremlin. They include “Our Lady of Yaroslavl” and “The Virgin of Vladimir” among the icons, Ivan Kramskoy's “Unknown Woman” and Vasily Perov's “Dostoevsky” among the portraits, and Arkhip Ivanovich Kuindzhi's “At Night” and Vasily Polenov's “Moscow Courtyard” among the landscapes.

Thomas Krenz, the Guggenheim's director, traces the genesis of the project back to a conversation he had three years ago in Venice with Mikhail Shwydkoi, the Russian culture minister of the day. They agreed that, while the Russian avant-garde was much admired in the West, Russian art of

earlier centuries was scarcely known at all. Together they set about planning an exhibition to plug this gap.

The Hermitage, Russia's pre-eminent state museum, was an immediate supporter. It has been sharing collections and organising exhibitions with the Guggenheim for the past five years. Vladimir Potanin, a Russian business tycoon who is chairman of the Hermitage's trustees and also a trustee of the Guggenheim, put up half the $4m needed to stage “Russia!”. The Guggenheim and the Hermitage have a small joint museum in Las Vegas which will house an exhibition of Russian imperial clothing and jewellery as a complement to the New York show.

For most foreign visitors, the main value of “Russia!” will lie in its 19th-century works. Here Russian painters can be caught at the moment when they ceased to imitate their French and Italian contemporaries, as they had done under Catherine the Great, and started to discover their own distinct country of mysterious landscapes, fading light, desperate peasants and brooding great men. In Perov's portrait of Dostoevsky, says Robert Rosenblum, professor of modern European art at New York University and a curator at the Guggenheim, “We see no hint of the sitter's public identity, only of his private genius—the record of a desolate, middle-aged man, totally shrouded in darkness, hands clasped as if to contain for a moment what we intuit as a frightening inner turbulence.” The weight of sadness bears down even on the landscapes of the time, deserted save for a wandering animal or a weather-beaten hovel.

The Russian avant-garde painting of the early 20th century is scarcely less wondrous in its way. But its presence here is less striking, because many of the artists and pieces are already well known abroad, thanks to past exhibitions such as the Guggenheim's “The Great Utopia” in 1992, which explored the revolutionary and early Soviet period. Even so, “Russia!” will broaden the understanding of this avant-garde in the West, by placing it in a Russian historical context. The western eye understands Kasimir Malevich's “Black Square” primarily as a work of minimalism, for example. The Russian eye places it within the tradition of the icon.

A score of socialist-realist paintings, and works from the perestroika and post-communist era by such artists as Ilya Kabakov, Igor Makarevich and Sergei Bugaev, complete the show. The socialist realism veers between affected innocence and criminal hypocrisy; the post-communist work is mostly inconsequential. They are there to remind us that life in Russia goes on, and not always for the better.

“Russia!” is at the Guggenheim Museum in New York from September 16th until January 11th 2006.

“Russia! The Majesty of the Tsars: Treasures from the Kremlin Museum” is at the Guggenheim Hermitage Museum in Las Vegas until January 15th 2006

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America's legal system

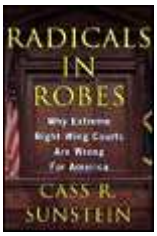
Divide and rule

Sep 15th 2005
From The Economist print edition

FOR most people not directly caught up in the maelstrom swirling around the appointment of new justices to the Supreme Court, the whole process can seem a trifle strange. The appointments of top judges in other countries barely make the news. In America they have often been a political circus. After years of respite, this peculiar ritual has started again as the Senate began its confirmation hearings this week on John Roberts, George Bush's choice to replace the late William Rehnquist as chief justice of the Supreme Court.

With so many other problems piling up, Mr Bush seems to have little appetite for this battle. His choice of Mr Roberts, a smooth and colourless conservative, seems designed to avoid the partisan brawl which Supreme Court appointments have so often provoked. But even if he succeeds this time, Mr Bush has another seat on the court to fill, which seems bound to produce a bitter fight. And whether Mr Bush likes it or not, he may have to make one or two more Supreme Court appointments before leaving office; a number of justices are old or ailing.

Radicals in Robes: Why Extreme Right-Wing Courts are Wrong for America
By Cass Sunstein



Basic Books; 272 pages; $26 and £15.50

Buy it at
Amazon.com
Amazon.co.uk

Why all the fuss? Cass Sunstein's new book is perfectly timed to answer that question, and to make comprehensible the political theatricals surrounding Supreme Court confirmations. This is no easy task. In the past, all sides have accused their opponents of exactly the same thing: trying to hijack the country by packing the court with “activist” ideologues who push their own agenda rather than simply interpret the law. All pledge to protect the American constitution from the dastardly machinations of others.

Reuters

Mr Sunstein, a professor at the University of Chicago and one of America's leading commentators on legal topics, offers a concise and illuminating guide through this confusing thicket of claim and counter-claim. What he makes clear is that behind the facade of agreement about basic principles lie deep disagreements about the meaning of the constitution, the role of the Supreme Court and the direction in which America itself should be moving.

Mr Sunstein divides the contestants into three categories: perfectionists, minimalists and fundamentalists. He terms himself a minimalist, believing that the court should deal with individual cases as cautiously as possible, and not embrace whole-heartedly any single theory of constitutional interpretation. Minimalists are found among liberals and conservatives, but both types are pragmatic rather than ideological. Sandra Day O'Connor, the court's retiring justice, is a typical conservative example, as are the court's four centrist, non-conservative justices.

Perfectionists are epitomised by the liberal judges who dominated the Supreme Court under Earl Warren in the 1950s and 1960s when it delivered a series of landmark rulings on racial segregation, voting rights, criminal defendants, free speech and privacy. For perfectionists, the sweeping and vague terms of the constitution require the Supreme Court to use it merely as a framework for grappling with contemporary issues. Within this broad framework, the court must come up with the best solution at the time in an effort to “perfect” America. Under these terms, many American liberals are perfectionists, but none of the court's current sitting justices is.

Penny for your thoughts, John

At the other extreme are fundamentalists, says Mr Sunstein. They approach the constitution as religious fundamentalists approach scripture, believing that the constitution means precisely what it meant when it went into effect in 1789, and that the court's job is to apply only this meaning. Mr Bush's two favourite justices on the court, Antonin Scalia and Clarence Thomas, are fundamentalists.

For the past two decades, constitutional fundamentalism has evolved into a large movement with advocates in law schools, in think-tanks and on the bench of lower federal courts. Its aim is revolutionary: to restore what it claims is the “lost constitution” or the “constitution in exile”. This is the “original” constitution supposedly intended by the framers, which fundamentalists claim was still in force when a conservative court blocked Franklin Roosevelt's New-Deal legislation in the 1930s. This proved a turning point. Roosevelt tried and failed to pack the court with new members, but the court subsequently performed an abrupt U-turn anyway and allowed an unprecedented expansion of federal power, a move which many conservatives have never accepted.

Mr Sunstein argues that both perfectionists and fundamentalists are mistaken in the same way, advocating a form of judicial activism that is illegitimate, prone to error and anti-democratic. But fundamentalists are his real target. Warren-style liberal perfectionists hardly exist on the federal bench any longer.

However, fundamentalists, he argues, are a genuine threat to good governance because they have so little respect for the Supreme Court's own precedents or for Congress. If they ever obtain a court majority, he fears, they would sweep away many effective laws, on everything from civil rights to environmental protection. America's modern regulatory state would be dismantled. Many widely accepted boundaries, such as that between religion and government, could also disappear.

Mr Sunstein may seem alarmist, but most of these positions have been advocated for years by supporters of the “lost constitution”. He opposes fundamentalists not only because of the way they want to remake America, but also because he disputes their reading of history. There was no single “original intent” behind the constitution among its drafters or ratifiers. It was a much contested document; and the idea that it can only be applied as those in the 18th century would have interpreted it seems a bizarre idea.

Moreover, through careful analysis, Mr Sunstein shows that fundamentalists have been wildly inconsistent in applying constitutional history, referring to it only when it fits their policy goals. Too often, he says, their interpretation neatly fits only the agenda of the extreme edges of the Republican Party's right wing rather than any reasonable view of history. Fundamentalist judges are “radicals in robes”, he claims, not neutral, fair-minded arbiters.

Thus, as Mr Sunstein has written elsewhere, the Senate confirmation hearings should not waste

time on seeking Mr Roberts's views on abortion or any other single litmus test, but should instead aim at discovering whether he is one of these judicial radicals. Why do such hearings so often degenerate into a political battle? Mr Sunstein's answer is simple: because so much is at stake.

Radicals in Robes: Why Extreme Right-Wing Courts are Wrong for America.
By Cass Sunstein.
Basic Books; 272 pages; $26 and £15.50

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Google

Big and bigger

Sep 15th 2005 | SILICON VALLEY
From The Economist print edition

JOHN BATTELLE is Silicon Valley's Bob Woodward. One of the founders of *Wired* magazine, he has hung around Google for so long that he has come to be as close as any outsider can to actually being an insider. Certainly, Google's founders, Sergey Brin and Larry Page, and its chief executive, Eric Schmidt, believe that it is safer to talk to Mr Battelle than not to do so.

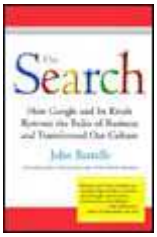
The result is a highly readable account of Google's astonishing rise—the steepest in corporate history—from its origins in Stanford University to its controversial stockmarket debut and its current struggle to become a grown-up company while staying true to its youthfully brash motto, “Don't be evil.” Mr Battelle makes the reader warm to Google's ruling triumvirate—their cleverness and their good intentions—and fear for their future as they take on the world.

Google is one of the most interesting companies around at the moment. It has a decent shot at displacing Microsoft as the next great near-monopoly of the information age. Its ambition—to organise all the world's information, not just the information on the world wide web—is epic, and its commercial power is frightening. Beyond this, Google is interesting for the same reason that secretive dictatorships and Hollywood celebrities are interesting—for being opaque, colourful and, simply, itself.

The book disappoints only when Mr Battelle begins trying to explain the wider relevance of internet search and its possible future development. There is a lot to say on this subject, but Mr Battelle is hurried and overly chatty, producing laundry lists of geeky concepts without really having thought any of them through properly. This is not a fatal flaw. Read only the middle chapters, and you have a great book.

The Search: How Google and Its Rivals Rewrote the Rules of Business and Transformed Our Culture
By John Battelle
Portfolio; 288 pages; $25.95.
Nicholas Brealey; £16.99

The Search: How Google and Its Rivals Rewrote the Rules of Business and Transformed Our Culture
By John Battelle



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Nicholas Brealey; £16.99.

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Economist.com BOOKS & ARTS

Fiction in France

Bleak chic

Sep 15th 2005 | PARIS
From The Economist print edition

The great French novel has all but vanished

THE French *rentrée* in September beckons not only children back to the classroom but also book-lovers to the bookshops. This month, 633 titles will be published in French, in a ritual known as *la rentrée littéraire*, a publishing blitz that the reading public finds increasingly bewildering. This year's list is double the length of that six years ago, and many titles end up unsold in the stockroom. Some hard questions are now being raised. How many of these novels are really worth reading? And why are so few of these authors known outside France?

Even francophiles in the English-speaking world find it hard to list many contemporary French novelists. First on most lists would be Michel Houellebecq, who made his name with the nihilist "Les Particules Elémentaires" ("Atomised") in 1998, and re-ignited controversy with "Plateforme" in 2001. Sure enough, his latest novel, "La Possibilité d'une Ile", just published in French and due out in Britain in November and America next April, is the season's sensation, prompting a fresh outburst of moral indignation.

The novel is a clever blend of futuristic biogenetic fantasy with a contemporary tale of immorality, inhumanity and the cult of youth. Set 2,000 years into the future, in a world of "neo-humans", the story unfolds through the eyes of Daniel24 and Daniel25. They are genetic clones of an original Daniel1, a self-loathing middle-aged comic who made his fortune writing misogynist, anti-Semitic and anti-Arab sketches and films, and now knocks himself out with pastis and anti-anxiety pills. His inhumanity is chilling: "The day my son committed suicide, I made myself *oeufs à la tomate*."

Daniel1's boredom is interrupted by two successive women: one, Isabelle, who offers love but not sex; the other, Esther, who supplies sex but not love. Ultimately, he finds consolation in his relationship with his loyal dog, Fox, and in a sect known as the Elohimites. Based on the island of Lanzarote, this sect offers hope in a morally bankrupt post-religious society by promising immortality. Each member over the age of 50 provides a DNA sample, compiles their life story and commits suicide. A day later, a clone re-emerges in adult form. By the time of Daniel24 and Daniel25, these neo-humans are troubled by the unfamiliar tales of love, desire, tears, suffering and disappointment—all feelings that have disappeared but which they discover in the writings of Daniel1.

La Possibilité d'une Ile
By Michel Houellebecq

Fayard; 485 pages; €22

Buy it at
Amazon.fr

Dans la Luge d'Arthur Schopenhauer
By Yasmina Reza

Albin Michel; 107 pages; €9

Buy it at
Amazon.fr

Acide Sulfurique
By Amélie Nothomb

Mr Houellebecq does not disappoint. His deftly constructed novel is a bleak comment on contemporary society, at times funny, brutal and revolting, which pushes notions of hope and hopelessness to a dismal logical conclusion. If there are weaknesses, it is the familiarity of themes from his previous work: the commodification of sex, the interaction between modern science and spirituality, the link between happiness and suffering. Moreover, the effort to shock with semi-pornographic scenes is increasingly tiresome; his female characters are flat; and, at times, the story-telling is slow. As always, the novel has divided critical opinion. *Lire*, a literary magazine, charitably called it "not completely *nul*", while *Le Monde* said it was his "most accomplished" work so far. Like it or loathe it, this book is certainly worth reading.

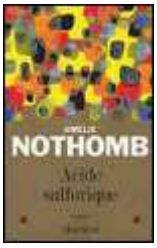
Bleakness, or *déprimisme*, is fashionable elsewhere. "Dans la Luge d'Arthur Schopenhauer" is a new novel by Yasmina Reza, whose thoughtful plays—"Conversations After a Burial", "Art", "Life x 3"—have been widely translated and performed. This is a finely observed study of solitude told through a series of monologues by four characters in late middle age. Foremost is Ariel Chipman, a philosophy professor who has dedicated his life to Spinoza and the theory of the supremacy of happiness. When confronted with the reality of his own deteriorating marriage, however, theory fails to rescue him.

"Acide Sulfurique", by Amélie Nothomb, a fashionable young writer, is another short though rather disappointing story that relies on a single, shocking idea: a reality television show called "Concentration", in which the contestants are captured, and the penalty for eviction is the death camp. There are some interesting ideas, notably that responsibility for immorality belongs to the consumer not the producer. But, with two pale central characters, a prisoner-contestant named Pannonique and Zdena, a guard, that is not quite enough.

Much of this season's crop has the regulation French mix of philosophy and bleak chic. But, a few exceptions aside, why are there not more arresting literary voices coming out of France today? Even the French bestseller lists are peppered with American or British names. The harsh answer, argues Richard Millet, a novelist and editor, in his recent book, "Harcèlement Littéraire", a devastating assault on the contemporary French novel, is that "French literature has become a desert." Few others would go so far, but some acknowledge a problem. "French literature as a dominating force no longer exists," concedes Susanna Lea, a Paris literary agent, "but it is more a wasteland than a desert: individual voices have emerged."

Mr Millet argues that the publishing binge at *la rentrée* reflects a devaluation of taste and judgment, and the triumph of celebrity marketing over literary merit and stylistic elegance. The production of short easy-read novelettes, he says, has been encouraged by discredited literary prizes, whose juries seldom rotate. "The same people write, edit and sit on prize juries, so nobody dares to criticise," he says. Others offer wider explanations. Some argue that the *nouveau roman* stifled the French novel, undermining the value of narrative. Others that literary leanness mirrors the stale political culture that is prevalent in a country where Jacques Chirac has been in politics for nearly 40 years.

What stir is caused by other writers, besides Mr Houellebecq, is thin.



Albin Michel; 193 pages; €15.90

Buy it at
Amazon.fr

La Petite Fille de Monsieur Linh
By Philippe Claudel

Stock; 160 pages; €15.50

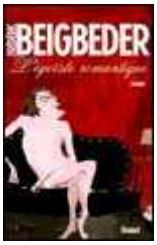
Buy it at
Amazon.fr

Vous Revoir
By Marc Levy

Robert Laffont; 342 pages; €21

Buy it at
Amazon.fr

L'Egoiste Romantique
By Frédéric Beigbeder



Philippe Claudel has just published the short but poignant “La Petite Fille de Monsieur Linh”. Another, less literary, voice is that of Marc Levy, whose latest work, “Vous Revoir”, returns to the characters of his earlier romantic comedy, “Et Si C'était Vrai”, due out soon as a Hollywood film. Another still is Frédéric Beigbeder, who has followed up his moving “Windows on the World” with the less assured “L'Egoiste Romantique”.

Grasset; 398 pages; €18

Buy it at
Amazon.fr

Controversy continues to dog Mr Houellebecq. Should he win the Goncourt, France's top literary prize, for which his book has just been shortlisted, the cronyism charges will re-surface. Some critics have already denounced Fayard for releasing the novel early only to a select few. Such indignation eclipses a far more interesting debate about the merits of the work itself—and of modern French fiction.

La Possibilité d'une Ile.
By Michel Houellebecq.
Fayard; 485 pages; €22

Dans la Luge d'Arthur Schopenhauer.
By Yasmina Reza.
Albin Michel; 107 pages; €9

Acide Sulfurique.
By Amélie Nothomb.
Albin Michel; 193 pages; €15.90

La Petite Fille de Monsieur Linh.
By Philippe Claudel.
Stock; 160 pages; €15.50

Vous Revoir.
By Marc Levy.
Robert Laffont; 342 pages; €21

L'Egoiste Romantique.
By Frédéric Beigbeder.
Grasset; 398 pages; €18

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Chinese books

Lupine luck

Sep 15th 2005 | BEIJING
From The Economist print edition

Wolf Totem.
By Jiang Rong.
Yangtze Art and Literature Press; 408 pages; 32 yuan

“WOLF TOTEM”, the cult Chinese novel by a pseudonymous author, that has sold more than 1m copies since it came out in April last year—and probably several million if pirated editions are included—is finally to be published in English. Late last month, Penguin secured the English-language rights for $100,000, the biggest advance ever paid by a foreign publisher for a novel from China.

The novel is based on the experiences of the author, Jiang Rong, an intellectual who volunteered to work as an agricultural labourer in the desolate steppes of Inner Mongolia during the Cultural Revolution of the 1960s and 1970s. While there he became familiar with the lives of nomads and wolves. Jiang Rong is the pseudonym of a Beijing academic whose real identity is known only to a few people, including this reviewer. The author is guarded about the reasons for keeping his name a secret. The Chinese authorities, wary of the book's success and worried that blacklisted writers might use pen names to avoid censorship, have recently ordered publishers to report the real identities of authors to the government.

The book's popularity lies partly in the appeal of its allegory to diverse groups of Chinese readers. For Chinese businessmen, some of whom have bought “Wolf Totem” in bulk to distribute among employees, it is an inspirational work about the entrepreneurial virtues of team work and cunning.

Mr Jiang says Chinese military officers have praised its insights into lupine techniques of subduing one's prey. Its popularity has already spawned numerous copycat works, all with the supposedly alluring word “wolf” in the title. But it is as a damning critique of Chinese culture that “Wolf Totem” has aroused the greatest attention. China's failing, the author suggests, is that it is not wolf-like. Its people are in some ways more like sheep, passive and easily controlled. The West is imbued with the competitive wolf spirit, which lies behind its technological attainments and the strength of its democratic pluralism. Heavy stuff for a novel, and not at all to the liking of ardent Chinese nationalists. Government praise could be a long time coming.

Wolf Totem.
By Jiang Rong.
Yangtze Art and Literature Press; 408 pages; 32 yuan

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Obituary

Eugenia Charles

Sep 15th 2005
From The Economist print edition

Corbis

Dame Mary Eugenia Charles, prime minister of Dominica, died on September 6th, aged 86

THE press photographs did no justice to how Eugenia Charles felt as she stood beside Ronald Reagan, at the White House, in October 1983. They showed a rather grim and melancholy woman, in a white cravat and executive striped suit. Only a vestigial twinkle in Reagan's eye suggested the truth: that Miss Charles was having the time of her life. “Mr President,” she told him afterwards in her lilting *basso profundo*, “you have big balls!”

She had just invited him to invade Grenada, and he had done so secretly, at once. That island, in the same chain as her own state of Dominica in the eastern Caribbean, had been taken over by Cuban-backed thugs and the moderate prime minister murdered. Miss Charles had raised the spectre of Cuban infiltration all over the region; Reagan, ever ready to wage clandestine war against Commies, had gallantly responded. A navy flotilla with marines had been diverted from its voyage to Lebanon to carry out her wishes and liberate the island. This was power.

Grenada was a member of the British Commonwealth; but even Margaret Thatcher was not told, a matter of some satisfaction. Miss Charles became impatient with the endless comparisons that were made between them. True, they were both hard-working daughters of the bourgeoisie, Red-haters and pioneers in male-dominated worlds. Both liked to let their hair down, at the end of a hard day of governing, by kicking off their shoes and indulging in something rather vulgar (Lady Thatcher swigging a large whisky, Dame Eugenia gnawing on a stick of sugar cane). Both made their opinions absolutely plain and were fearless in argument. The Iron Lady and the Iron Lady of the Caribbean met, and admired each other. But Miss Charles thought Mrs Thatcher had got too

fancy in her years in power.

She herself, though she ruled Dominica for 15 years, from 1980 to 1995, had little chance of hubris. Dominica was a tiny, troubled place, covered in volcanic jungle and short of everything but drug-runners and bananas. It was famous mostly for the slowness of its post, much of it being redirected from the Dominican Republic.

The year before Miss Charles became prime minister, Hurricane David wrecked the island. Whatever grand schemes she had for health care or education took a back seat to simple restoration of roads and power: “concrete and current”, in her phrase. Eventually, by dint of IMF loans, eco-tourism, economic reforms and favourable terms for Caribbean bananas, for which she haggled tirelessly, the island stabilised somewhat. It remained, like all its neighbours, vulnerable to everything.

Her enemies said she governed like a headmistress, and there was something in that. In her second term, all the big portfolios—finance, the economy, foreign affairs, defence—were in her capable hands. She banned casinos, night clubs and duty-free shops from Dominica, convinced that they brought bad elements in, and championed banana-growers because, if “yellow gold” failed, they would just grow ganja instead. The island's minute defence force was summarily disbanded in 1981 for disloyalty, reluctance to wield a shovel after the hurricane, and selling marijuana to Rastafarians. Miss Charles weathered two coups with withering disdain, once quietly leaving by the back door while soldiers piled in at the front.

The aunt type

At first she was a reluctant politician. Her training was in law, which she studied in Toronto and London. Back in Dominica in 1949, the first woman ever to set up a legal practice there, her energies were engaged in that for almost two decades. But government corruption increasingly outraged her. When, in 1968, a left-wing government brought in the Seditious and Undesirable Publications Act (the “Shut-Your-Mouth Bill”, as she called it) to suppress dissent, she led the opposition to it, got it withdrawn and was made the leader of the Dominica Freedom Party.

Miss Charles was never, however, the party type. She was the aunt type: a true Caribbean matriarch (though unmarried and childless), ruling the roost and dispensing wisdom with no feckless male around to steal the limelight. The men could bum in the sun; she would “look after the things that need looking after”. This was the extent of her ideology. Though she did various free-market things, to America's delight, she was no free-trader, and approved of co-operative ventures at every level. Her favourite reading was not Hayek, but Mills & Boon.

Her greatest political influence was probably her father, “J-B”, with whom she lived until he died at the age of 107. It was he who encouraged her to argue at the dinner table (conduct frowned on at the Convent of the Faithful Virgin, where she went to school). He also suggested she should take a secretarial course and practise her shorthand in the magistrate's court, which led to her career in law. J-B Charles was many things: a planter, a fruit-exporter, a land-speculator, a politician and, in the fishing village of Pointe Michel where the family lived, the founder of a “penny bank” to encourage poor farmers to save. Thrift, debate, self-reliance, self-improvement: it all sounds very like the moral and political training of a certain grocer's daughter from Grantham.

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Overview

Sep 15th 2005
From The Economist print edition

Japan's stockmarket welcomed the overwhelming victory of Junichiro Koizumi's Liberal Democratic Party in elections on September 11th. The Nikkei index rose by 1.6% in the first day of trading after the poll. Investors were also cheered by a giant revision to the growth figures. Japan's GDP grew at an annual rate of 3.3% in the second quarter, not 1.1% as previously thought.

Americans spent more at petrol pumps in August, and much less at car showrooms. Vehicle sales plunged by 12.9%, after soaring by 6.8% the month before. Sales at petrol stations rose by 4.4%, thanks largely to higher prices after Hurricane Katrina. And yet the hurricane's effects are already starting to abate. The average price of **petrol** at the pump fell below $3 a gallon this week, according to the Energy Information Administration, as the links in America's battered supply chain were slowly restored. The price fell by over 11 cents between September 5th and 12th, the largest weekly drop on record.

America's industrial production expanded by just 0.1% in August. The same month **producer prices** rose by 0.6%, leaving them 5.1% higher than the year before, and **retail sales** fell in value by 2.1%. In July the **trade deficit** in goods and services narrowed to $57.9 billion; $1.6 billion less than in June.

In **France**, industrial production fell by 0.7% in the year to July. In the **Netherlands**, it grew by 0.1% over the same period, but slipped by 0.2% in July compared to the month before.

Britain's consumer prices rose by 2.4% in the year to August, thanks to increasing transport and fuel prices. This is the fastest rate of inflation since the consumer-price index was introduced in 1997, and well above the Bank of England's target of 2.0%. Wage pressures may however be easing somewhat. Average earnings, excluding bonuses, increased by 3.9% in the three months to July, the slowest pace of growth since February 2004.

Canada's exports in July, worth C$38 billion ($31 billion), were the third-highest on record, thanks to booming sales of petroleum to its southern neighbour. Canada chalked up a trade surplus of C$5.82 billion in July, up 19.5% on the month before.

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Output, demand and jobs

Sep 15th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q2	+ 5.2	+ 2.4	+ 3.2	+ 1.2	Q1	+ 1.6	Q2	5.0	Aug	5.7
Austria	+ 2.0	Q1	+ 0.8	+ 1.9	+ 2.0	+ 5.8	Jun	+ 1.7	Jun	5.2	Aug	4.9
Belgium	+ 1.5	Q2	+ 1.2	+ 1.2	+ 1.9	– 4.0	Jul	+ 5.9	Jun	13.4	Jul†	12.8
Britain	+ 1.7	Q2	+ 1.5	+ 2.0	+ 2.2	– 1.6	Jul	+ 1.8	Jul	4.7	Jul††	4.7
Canada	+ 2.7	Q2	+ 3.2	+ 2.8	+ 3.0	+ 0.4	Jun	+ 5.9	Jun	6.8	Aug	7.1
Denmark	+ 0.8	Q1	+ 0.6	+ 2.0	+ 2.2	– 1.6	Jul	+ 6.1	Jul	5.8	Jul	6.2
France	+ 1.2	Q2	+ 0.4	+ 1.4	+ 1.8	– 0.7	Jul	– 1.2	Jul	9.9	Jul	10.0
Germany	+ 0.6	Q2	nil	+ 0.9	+ 1.3	+ 3.0	Jul	– 3.0	Jul	11.6	Aug§	10.6
Italy	+ 0.1	Q2	+ 2.8	– 0.2	+ 1.0	– 3.0	Jun	– 1.5	Jun	7.8	Mar	8.2
Japan	+ 1.4	Q2	+ 3.3	+ 1.9	+ 1.9	– 2.2	Jul	+ 3.6	Jun	4.4	Jul	4.9
Netherlands	+ 1.3	Q2	+ 4.9	+ 0.5	+ 1.6	+ 0.1	Jul	+ 1.2	Jun	6.6	Aug**	6.2
Spain	+ 3.4	Q2	+ 3.6	+ 3.2	+ 2.8	– 3.5	Jul	+ 0.4	Jul	9.4	Jul	10.9
Sweden	+ 2.2	Q2	+ 2.4	+ 2.1	+ 2.7	+ 7.8	Jul	+ 8.6	Jul	6.9	Jul†	5.6
Switzerland	+ 1.0	Q2	+ 1.1	+ 0.8	+ 1.5	– 0.3	Q1	+ 3.2	Jun	3.6	Aug†	3.7
United States	+ 3.6	Q2	+ 3.3	+ 3.7	+ 3.3	+ 3.1	Aug	+ 7.5	Jul	4.9	Aug	5.4
Euro area	+ 1.1	Q2	+ 1.2	+ 1.3	+ 1.7	+ 0.3	Jun	nil	Jul	8.6	Jul	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.2	Q2	– 6.3	na	na	+ 0.7	Jul	+ 5.8	Jun	7.3	Jul†	7.8
Greece	+ 3.7	Q2	na	na	na	– 4.5	Jul	+ 3.9	Jun	9.9	Mar	10.8
Iceland	+ 2.9	Q1	na	na	na	na		na		2.1	Jun†	3.1
Ireland	+ 2.4	Q1	+ 1.0	na	na	– 3.2	Jul	+ 3.4	Jun	4.3	Aug	4.4
Luxembourg	+ 3.1	Q1	na	na	na	+11.2	May	– 1.4	Jul	4.4	Jul	4.0
New Zealand	+ 1.9	Q1	+ 1.5	na	na	+ 3.5	Q4	+ 5.9	Q2	3.7	Q2	4.0
Norway	+ 4.8	Q2	+ 5.2	na	na	– 1.3	Jul	+ 7.3	Jul	4.7	Jul‡	4.5
Portugal	+ 0.5	Q2	+ 4.1	na	na	+ 1.2	Jun	– 1.9	Jul	7.2	Q2†	6.3

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††May-Jul; claimant count rate 2.8% in Aug.
§EU harmonised rate 9.0% in Jul. **May-Jul.

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Prices and wages

Sep 15th 2005
From The Economist print edition

% change on year ago

	Consumer prices		The Economist poll consumer prices forecast		Producer prices		Wages/earnings	
	latest	year ago	2005	2006	latest	year ago	latest	year ago
Australia	+ 2.5 Q2	+ 2.5	+ 2.7	+ 2.7	+ 6.9 Q2	+ 2.8	+ 5.8 Q2	+ 3.0
Austria	+ 2.2 Jul	+ 2.2	+ 2.1	+ 1.8	+ 0.9 Aug	+ 6.3	+ 2.3 Jul	+ 2.0
Belgium	+ 3.1 Aug	+ 2.3	+ 2.4	+ 2.0	+ 1.8 Jul	+ 5.5	+ 2.6 Apr	+ 2.3
Britain	+ 2.4 Aug*	+ 1.3	+ 2.0	+ 1.9	+ 3.0 Aug	+ 2.8	+ 4.2 Jul†	+ 3.8
Canada	+ 2.0 Jul	+ 2.3	+ 2.1	+ 2.2	– 0.3 Jul	+ 5.5	+ 1.4 Jun	+ 2.5
Denmark	+ 2.2 Aug	+ 1.2	+ 1.6	+ 1.8	+ 4.7 Jul	+ 2.7	+ 2.9 Q2	+ 3.1
France	+ 1.8 Aug	+ 2.4	+ 1.8	+ 1.6	+ 2.9 Jun	+ 2.2	+ 2.9 Q2	+ 2.8
Germany	+ 1.9 Aug	+ 2.0	+ 1.7	+ 1.6	+ 1.9 Aug	+ 4.2	+ 0.9 Jun	+ 1.4
Italy	+ 2.0 Aug	+ 2.3	+ 2.1	+ 1.9	+ 3.6 Jul	+ 3.3	+ 2.8 Jul	+ 3.2
Japan	– 0.3 Jul	– 0.1	– 0.1	+ 0.3	+ 1.7 Aug	+ 1.7	+ 3.7 Jul	+ 1.7
Netherlands	+ 1.8 Aug	+ 1.1	+ 1.4	na	+ 5.6 Jul	+ 5.2	+ 0.9 Aug	+ 1.0
Spain	+ 3.3 Aug	+ 3.3	+ 3.2	+ 2.9	+ 4.6 Jul	+ 4.1	+ 2.5 Q1	+ 3.2
Sweden	+ 0.6 Aug	+ 0.6	+ 0.5	+ 1.3	+ 3.7 Jul	+ 1.9	+ 2.6 Jun	+ 1.6
Switzerland	+ 1.0 Aug	+ 1.0	+ 1.1	+ 1.1	+ 1.0 Aug	+ 1.5	+ 0.9 2004	+ 1.4
United States	+ 3.2 Jul	+ 3.0	+ 3.0	+ 2.7	+ 5.1 Aug	+ 3.4	+ 2.7 Aug	+ 2.2
Euro area	+ 2.1 Aug	+ 2.3	+ 2.1	+ 1.8	+ 4.0 Jul	+ 2.9	+ 3.1 Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 0.9 Aug	+ 0.4	na	na	+ 4.0 Jul	+ 1.5	+ 4.0 Q2	+ 3.8
Greece	+ 3.7 Aug	+ 2.7	na	na	+ 5.1 Jul	+ 4.7	na	na
Iceland	+ 3.7 Aug	+ 3.7	na	na	+ 4.3 Aug	+ 5.7	+ 6.6 Jul	+ 5.1
Ireland	+ 2.3 Aug	+ 2.6	na	na	+ 0.2 Jul	– 0.7	+ 6.4 Q1	+ 3.9
Luxembourg	+ 2.7 Aug	+ 2.3	na	na	+ 5.4 Jun	+ 9.2	+ 1.6 Jun	+ 2.8
New Zealand	+ 2.8 Q2	+ 2.4	na	na	+ 4.7 Q2	+ 1.5	+ 2.6 Q2	+ 2.3
Norway	+ 1.9 Aug	+ 1.0	na	na	+19.9 Aug	+16.4	+ 3.8 Q2	+ 4.1
Portugal	+ 2.6 Aug	+ 2.3	na	na	+ 4.0 Jul	+ 4.2	– 0.2 Jun	– 0.1

*RPI inflation rate 2.8% in Aug. †May-Jul.

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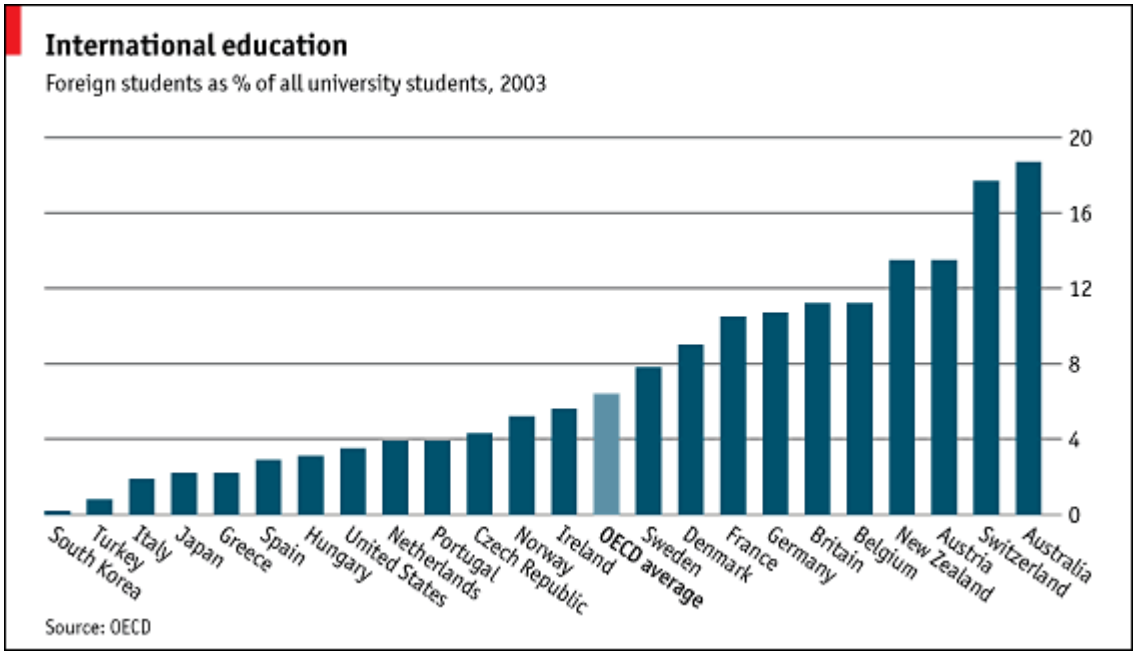
International education

Sep 15th 2005
From The Economist print edition



Foreign students are most visible in Australian and Swiss universities, where they make up more than 17% of all students. Although America attracts more than a quarter of the world's foreign students, they account for only 4% of America's student population. Almost half of all foreign students come from Asia, particularly China and India. Social sciences, business and law are the fields of study most popular with overseas scholars.

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Money and interest rates

Sep 15th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Sep 14th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.5	+ 8.8	Jul	5.62	5.41	5.07	5.15	5.33	6.17
Britain	+ 4.9	+11.5	Jul	4.56	4.78	4.17	4.17	4.91	5.18
Canada	+ 6.5	+10.2	Jul	2.74	2.36	3.09	3.86	4.64	5.12
Denmark	+22.0	+15.7	Jul	2.20	2.25	2.21	3.02	4.14	4.86
Japan	+ 4.4	+ 1.7	Aug	0.02	0.02	0.18	1.35	1.53	1.44
Sweden	+ 3.6	+ 8.1	Jul	1.47	1.98	2.06	2.94	4.32	2.74
Switzerland	+ 0.5	+ 7.3	Jul	0.76	0.67	1.04	1.80	2.61	1.86
United States	+ 1.1	+ 5.0	Jul	3.84	1.84	3.89	4.16	4.17	5.15
Euro area†	+11.1	+ 7.9	Jul	2.14	2.12	2.18	3.06	4.02	3.34

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.45%, Japan No. 272 1.36%. Central bank rates: US fed funds 3.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Sep 15th 2005
From The Economist print edition

2000=100

	Sep 6th	Sep 13th*	% change on one month	% change on one year
Dollar index				
All items	134.5	132.0	– 0.4	+ 8.6
Food	124.0	121.7	– 1.2	+ 5.1
Industrials				
All	148.1	145.4	+ 0.5	+12.6
Nfa†	135.3	135.2	+ 6.3	+ 2.3
Metals	155.0	151.0	– 2.1	+18.4
Sterling index				
All items	110.7	109.8	– 1.1	+ 7.2
Euro index				
All items	99.7	99.4	+ 0.0	+ 8.6
Yen index				
All items	137.0	135.7	+ 1.0	+ 9.8
Gold				
$ per oz	443.95	446.55	+ 0.6	+10.0
West Texas Intermediate				
$ per barrel	65.81	63.07	– 4.6	+42.0

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

Sep 15th 2005
From The Economist print edition

Market indices

	Sep 14th	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,473.6	4,473.6	3,905.5	+ 0.4	nil	+10.4	+ 8.8
Austria (ATX)	3,405.6	3,405.6	2,415.0	+ 2.3	nil	+40.1	+26.8
Belgium (Bel 20)	3,266.3	3,314.8	2,958.8	+ 0.3	-11.3	+11.4	+ 0.8
Britain (FTSE 100)	5,347.4	5,377.5	4,783.6	- 0.3	-22.8	+11.1	+ 5.7
Canada (Toronto Composite)	10,932.4	10,932.4	9,006.2	+ 1.2	- 4.0	+18.2	+20.0
Denmark (KBX)	337.2	337.5	257.8	+ 0.7	- 0.1	+30.8	+18.1
France (SBF 250)	3,121.3	3,146.1	2,633.6	- 0.2	-28.9	+18.5	+ 7.3
(CAC 40)	4,470.4	4,527.1	3,816.1	- 0.4	-35.4	+17.0	+ 5.9
Germany (DAX)*	4,911.2	5,005.9	4,178.1	- 1.5	-39.1	+15.4	+ 4.5
Italy (S&P/MIB)	34,320.0	34,320.0	30,645.0	+ 0.7	-31.5	+11.1	+ 0.6
Japan (Nikkei 225)	12,834.3	12,902.0	10,825.4	+ 1.8	-67.0	+11.7	+ 4.0
(Topix)	1,312.4	1,315.8	1,109.2	+ 2.1	-54.5	+14.2	+ 6.2
Netherlands (AEX)	393.9	401.6	347.0	- 0.1	-43.9	+13.2	+ 2.5
Spain (Madrid SE)	1,127.6	1,132.2	950.9	+ 0.3	- 1.6	+17.6	+ 6.5
Sweden (Affarsvarlden Gen)	264.4	264.4	218.9	+ 1.1	-33.9	+19.5	+ 4.8
Switzerland (Swiss Market)	6,731.6	6,731.6	5,669.6	+ 0.7	-20.0	+18.2	+ 7.1
United States (DJIA)	10,544.9	10,940.6	10,012.4	- 0.8	-10.0	- 2.2	- 2.2
(S&P 500)	1,227.2	1,245.0	1,137.5	- 0.7	-19.7	+ 1.3	+ 1.3
(NASDAQ Comp)	2,149.3	2,218.2	1,904.2	- 1.0	-57.4	- 1.2	- 1.2
Europe (FTSEurofirst 300)†	1,205.3	1,209.8	1,038.6	nil	-29.3	+15.7	+ 4.8
Euro area (FTSE Euro 100)†	1,019.2	1,026.7	894.4	- 0.3	-34.3	+13.1	+ 2.4
World (MSCI)‡	1,215.6	1,225.6	1,115.0	- 0.4	-16.1	+ 4.0	+ 4.0
World bond market (Citigroup)††	647.1	662.3	626.9	- 0.6	- 2.3	- 2.9	- 2.9

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Sep 15th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Sep 14th	year ago	Currency units per $ Sep 14th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 16.5	Jul	− 43.1	Q2	− 5.9	− 5.5	118.3	107.9	1.29	1.44	2.37	1.59	1.18	+ 0.9
Austria	− 1.5	Jun	nil	Jun	− 0.4	− 0.3	103.9§	104.0	0.81	0.82	1.48	–	0.74	− 2.0
Belgium	+ 15.1	Jun	+ 12.2	Mar	+ 2.8	+ 2.7	104.4§	104.4	0.81	0.82	1.48	–	0.74	− 0.5
Britain	−114.3	Jul	− 44.0	Q1	− 2.4	− 2.5	100.6	99.4	0.55	0.56	–	0.67	0.50	− 2.9
Canada	+ 46.5	Jul	+ 16.3	Q2	+ 1.4	+ 1.2	122.1	110.9	1.18	1.30	2.16	1.45	1.07	+ 1.2
Denmark	+ 9.8	Jul	+ 11.5	Jul	+ 2.1	+ 1.9	105.6	106.1	6.06	6.12	11.1	7.46	5.50	+ 1.8
France	− 27.8	Jul	− 22.6	Jun	− 0.7	− 0.5	106.9§	107.0	0.81	0.82	1.48	–	0.74	− 3.0
Germany	+198.8	Jul	+110.5	Jul	+ 3.6	+ 3.4	104.6§	104.7	0.81	0.82	1.48	–	0.74	− 3.5
Italy	− 6.1	Jun	− 24.9	Jun	− 1.3	− 1.5	76.5§	76.6	0.81	0.82	1.48	–	0.74	− 4.4
Japan	+110.4	Jul	+165.8	Jul	+ 3.4	+ 3.3	86.3	87.2	110	110	201	136	–	− 6.1
Netherlands	+ 40.9	Jun	+ 28.3	Q2	+ 3.7	+ 3.6	103.9§	103.9	0.81	0.82	1.48	–	0.74	− 2.2
Spain	− 89.4	Jun	− 72.6	May	− 5.4	− 5.5	77.2§	77.2	0.81	0.82	1.48	–	0.74	+ 0.5
Sweden	+ 22.2	Jul	+ 27.9	Q2	+ 6.7	+ 6.2	96.1	98.6	7.58	7.51	13.9	9.33	6.89	+ 0.8
Switzerland	+ 7.1	Jul	+ 40.2	Q1	+11.4	+11.0	106.8	107.0	1.26	1.27	2.29	1.55	1.14	− 1.0
United States	−730.7	Jul	−717.0	Q1	− 6.3	− 6.3	84.4	87.2	–	–	1.83	1.23	0.91	− 4.1
Euro area	+ 61.5	Jun	+ 16.1	Jun	+ 0.3	+ 0.2	115.5	115.7	0.81	0.82	1.48	–	0.74	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.0	Jul	+ 6.4	Jul	na	na	81.5§	81.6	0.81	0.82	1.48	–	0.74	+ 1.3
Greece	− 33.6	Jun	− 15.5	Jun	na	na	59.9§	59.9	0.81	0.82	1.48	–	0.74	− 3.8
Iceland	− 1.0	Jul	− 1.6	Q2	na	na	102.8**	95.4	62.7	72.0	115	77.1	56.9	+ 1.1
Ireland	+ 40.2	Jun	− 3.1	Q1	na	na	94.1§	94.0	0.81	0.82	1.48	–	0.74	− 0.7
Luxembourg	− 4.4	Jun	+ 3.0	Q1	na	na	104.4§	104.4	0.81	0.82	1.48	–	0.74	− 0.8
New Zealand	− 3.7	Jul	− 7.0	Q1	na	na	137.8	131.0	1.43	1.52	2.61	1.76	1.30	+ 3.2
Norway	+ 43.3	Aug	+ 40.8	Q2	na	na	111.7	103.5	6.35	6.92	11.6	7.81	5.77	+ 14.4
Portugal	− 22.3	Jun	− 15.7	Jun	na	na	94.1**	93.6	0.81	0.82	1.48	–	0.74	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, July average. ‡OECD forecast. **IMF, May average.

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The Economist food index

Sep 15th 2005
From The Economist print edition

Our food index has fallen by 12% since March, partly on expectations of good maize and soyabean harvests in America. But sugar is at a near five-year high; Brazil may divert more cane into ethanol .

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Overview

Sep 15th 2005
From The Economist print edition

China's economy continues to flourish. Industrial production grew by 16.0% in the year to August. Inflation eased to 1.3% over the same period. The 12-month trade surplus swelled in August to $93.1 billion.

In **India**, by contrast, industrial-output growth slackened to 6.7% in the year to July. The 12-month trade deficit increased in August to $34.7 billion.

Mexico's industrial production declined by 1.1% in the year to July.

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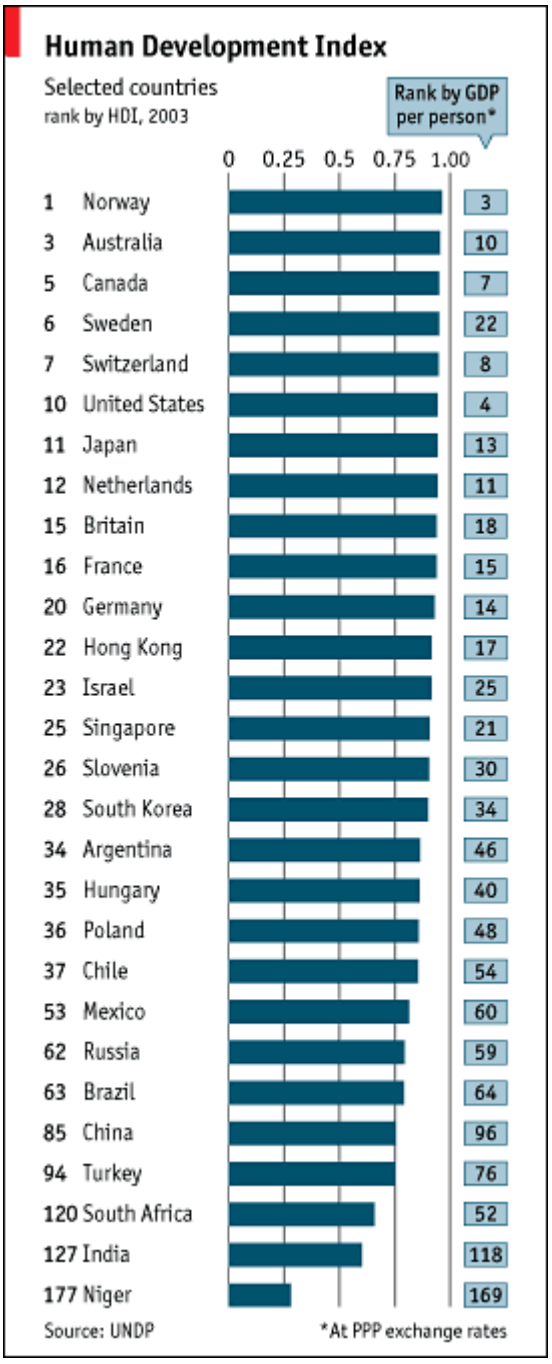
Human Development Index

Sep 15th 2005
From The Economist print edition

Norway has the highest standard of living in the world and Niger the lowest, according to the UN's Human Development Index. The index takes into account life expectancy and education as well as income per person. South Africa's AIDS epidemic has left it in 120th place in the rankings, despite its relatively high income. The country has fallen 35 places since 1990.



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Economy

Sep 15th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q2	+16.0	Aug	+ 1.3	Aug	+93.1	Aug	+68.7	2004	711.0	Jun
Hong Kong	+ 6.8	Q2	– 0.6	Q1	+ 1.3	Jul	– 9.6	Jul	+18.5	Q1	122.3	Aug
India	+ 7.0	Q1	+ 6.7	Jul	+ 4.1	Jul	–34.7	Aug	– 6.4	Q1	133.6	Aug
Indonesia	+ 5.5	Q2	+ 7.3	Jul	+ 8.3	Aug	+27.8	Jul	+ 7.8	Q1	31.0	Jul
Malaysia	+ 4.1	Q2	+ 0.9	Jul	+ 3.7	Aug	+23.6	Jul	+16.7	Q1	78.0	Jul
Philippines	+ 4.8	Q2	– 0.1	Jun	+ 7.2	Aug	– 0.8	Jun	+ 2.9	Mar	15.3	Aug
Singapore	+ 5.2	Q2	+ 5.9	Jul	+ 0.1	Jul	+16.9	Jul	+32.5	Q2	116.4	Aug
South Korea	+ 3.3	Q2	+ 7.0	Jul	+ 2.0	Aug	+26.0	Aug	+21.3	Jul	205.6	Jul
Taiwan	+ 3.0	Q2	– 1.1	Jul	+ 3.6	Aug	+ 1.7	Aug	+13.3	Q2	254.1	Aug
Thailand	+ 4.4	Q2	+ 4.7	Jul	+ 5.6	Aug	– 7.3	Jul	– 2.2	Jul	47.3	Jul
Argentina	+ 8.0	Q1	+ 6.0	Jul	+ 9.7	Aug	+11.2	Jul	+ 2.8	Q1	24.4	Jul
Brazil	+ 3.9	Q2	+ 0.5	Jul	+ 6.0	Aug	+40.1	Aug	+13.4	Jul	54.6	Aug
Chile	+ 6.5	Q2	+ 4.4	Jul	+ 3.0	Aug	+ 8.7	Aug	+ 0.6	Q2	15.8	Aug
Colombia	+ 3.6	Q1	+ 3.0	Jun	+ 4.9	Aug	+ 1.6	May	– 0.8	Q1	14.9	Aug
Mexico	+ 3.1	Q2	– 1.1	Jul	+ 4.0	Aug	– 9.6	Jul	– 8.4	Q2	66.4	Jul
Peru	+ 4.9	Jul	+ 5.9	Jun	+ 1.2	Aug	+ 3.8	Jun	+ 0.4	Q2	12.8	Aug
Venezuela	+11.1	Q2	+ 6.2	Jun	+14.8	Aug	+24.7	Q2	+17.7	Q2	23.1	Jun
Egypt	+ 4.7	Q4	+ 3.3	2004†	+ 4.7	Jun	– 9.5	Q1	+ 4.4	Q1	18.5	Jul
Israel	+ 4.8	Q2	+ 0.5	Jun	+ 1.6	Jul	– 8.0	Jul	+ 1.9	Q1	27.8	Aug
South Africa	+ 4.5	Q2	+ 2.4	Jul	+ 3.4	Jul	– 2.3	Jul	– 8.5	Q1	17.2	Aug
Czech Republic	+ 5.1	Q2	+11.2	Jul	+ 1.7	Aug	+ 1.3	Jul	– 4.1	Q2	30.2	Aug
Hungary	+ 4.1	Q2	+ 8.4	Jul	+ 3.6	Aug	– 3.4	Jul	– 9.2	Q1	18.0	Aug
Poland	+ 2.8	Q2	+ 2.6	Jul	+ 1.6	Aug	– 3.3	Jul	– 0.2	Jun	39.4	Jul
Russia	+ 6.1	Q2	+ 4.9	Jul	+12.4	Aug	+110.6	Jul	+69.2	Q1	146.0	Aug
Turkey	+ 4.8	Q1	– 0.3	Jul	+ 7.9	Aug	–38.9	Jul	–20.0	Jul	42.9	Jul
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.0	Q2	+11.1	Jul	+ 4.2	Aug	– 2.3	Jun	– 1.3	Jun	1.8	Jul
Latvia	+11.6	Q2	+ 5.0	Jul	+ 6.1	Aug	– 2.7	Jun	– 1.5	Jun	2.1	Jul
Lithuania	+ 8.2	Q2	na		+ 1.3	Aug	– 3.1	Jul	– 1.5	Q1	3.4	Jul
Slovakia	+ 5.1	Q2	+ 4.7	Jul	+ 2.0	Sep	– 2.0	Jul	– 2.3	May	15.3	Jul
Slovenia	+ 5.2	Q2	+ 1.0	Jun	+ 2.0	Aug	– 1.3	Jul	nil	Jun	8.1	Jun
Pakistan	+ 8.4	2005†	+13.6	Apr	+ 9.0	Jul	– 6.7	Jul	– 1.5	Q2	10.4	May
Saudi Arabia	+ 5.2	2004	na		+ 0.6	Jun	+84.9	2004	+51.5	2004	24.8	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June.

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Financial markets

Sep 15th 2005
From The Economist print edition

	Currency units per $ Sep 14th	Currency units per $ year ago	Currency units per £ Sep 14th	Interest rates short-term % a year	Stockmarkets Sep 14th	% change on one week	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
China	8.09	8.28	14.8	4.38	1,279.2	+1.9	– 3.8	– 1.6
Hong Kong	7.76	7.80	14.2	3.83	15,086.6	–0.9	+ 6.0	+ 6.2
India	43.8	45.8	80.1	5.19	8,189.5	+3.1	+ 24.0	+ 23.0
Indonesia	10,000	9,115	18,272	13.33	1,058.6	–0.1	+ 5.8	– 1.8
Malaysia	3.77	3.80	6.89	2.90	914.7	–0.5	+ 0.8	+ 1.6
Philippines	55.9	56.2	102.2	7.31	1,914.7	+0.9	+ 5.0	+ 5.4
Singapore	1.68	1.69	3.07	2.12	2,313.4	+0.7	+ 12.0	+ 8.9
South Korea	1,026	1,144	1,874	3.64	1,170.8	+2.4	+ 30.7	+ 31.9
Taiwan	32.8	33.8	59.9	1.45	6,148.7	+0.1	+ 0.1	– 3.2
Thailand	40.9	41.3	74.8	4.00	717.8	+1.3	+ 7.4	+ 2.0
Argentina	2.92	2.99	5.34	6.69	1,618.1	+0.6	+ 17.6	+ 19.7
Brazil	2.33	2.90	4.25	19.74	29,049.0	+0.7	+ 10.9	+ 26.5
Chile	536	615	980	3.84	9,893.4	+1.8	+ 10.4	+ 14.4
Colombia	2,290	2,533	4,184	6.86	6,770.4	–3.3	+ 55.8	+ 60.0
Mexico	10.9	11.5	19.8	9.21	15,221.4	–0.2	+ 17.8	+ 21.0
Peru	3.29	3.35	6.01	2.97	4,858.3	+2.5	+ 30.9	+ 30.6
Venezuela	2,651§	2,535§	4,844	11.11	21,301.6	+2.3	– 28.9	– 30.8
Egypt	5.77	6.23	10.54	9.20	44,638.4	+0.1	+ 81.6	+ 91.1
Israel	4.52	4.48	8.26	3.72	745.3	+2.1	+ 15.8	+ 10.6
South Africa	6.35	6.58	11.6	7.05	15,984.7	+0.3	+ 26.3	+ 12.1
Czech Republic	23.8	25.8	43.5	1.79	1,390.3	+2.7	+ 34.7	+ 26.5
Hungary	199	203	364	5.81	22,745.7	+3.9	+ 54.3	+ 39.9
Poland	3.18	3.57	5.81	4.54	32,468.5	+1.8	+ 21.9	+ 14.8
Russia	28.3	29.2	51.7	13.00	896.1‡	+3.4	+ 49.0	+ 45.9
Turkey	1.34	1.50	2.45	15.80	32,540.2	+3.7	+ 30.3	+ 31.0
EM (MSCI)*	1.00	1.00	1.83	na	635.6	+1.2	+ 17.2	+ 17.2
EMBI+†	1.00	1.00	1.83	na	357.3	+0.7	+ 8.4	+ 8.4

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

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